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No. 98-___

In The

Supreme Court of the United States

October Term, 1997

BANK ONE, MILWAUKEE, N.A.,

Petitioner,

v.

P.A. BERGNER & CO.,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether the "new value" defense under 11 U.S.C. § 547(c)(1) requires a debtor to receive new value from the allegedly preferred creditor, as opposed to receiving it from a third party.

2. Whether the "ordinary course of business" defense under 11 U.S.C. § 547(c)(2) requires the existence of past similar transactions between a debtor, when it was financially healthy, and the allegedly preferred creditor.

PARTIES TO THE PROCEEDINGS

All parties below and here are listed in the caption. Petitioner Bank One, Milwaukee, N.A. is a subsidiary of Banc One Corporation, which is a publicly-held corporation. Petitioner has no partially owned subsidiaries.

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PETITION FOR A WRIT OF CERTIORARI

Bank One, Milwaukee, N.A., respectfully petitions for a writ of certiorari to review the judgment of United States Court of Appeals for the Seventh Circuit.

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a) is reported at 140 F.3d 1111. The opinion of the district court (Pet. App. 28a) is unreported. The opinion of the bankruptcy court (Pet. App. 65a) is reported at 187 Bankr. 964.

JURISDICTION

The judgment of the court of appeals was entered on April 6, 1998. A timely petition for rehearing was denied on June 3, 1998. Pet. App. 107a. This Court has jurisdiction under 28 U.S.C. § 1254(1).

STATUTES INVOLVED

Pertinent provisions of 11 U.S.C. § 547(b) and (c) are reproduced in the appendix. Pet. App. 134a.

STATEMENT

This case presents two important questions about the scope of preference defenses under the bankruptcy code: first, whether the "new value" defense under 11 U.S.C. § 547(c)(1) requires a debtor to receive new value directly from the allegedly preferred creditor; and second, whether the "ordinary course of business" defense under 11 U.S.C. § 547(c)(2) requires the existence of past similar transactions between a debtor, when it was still financially healthy, and the allegedly preferred creditor.

1. Section 547(b) of the Bankruptcy Code, 11 U.S.C. § 547(b), authorizes a bankruptcy trustee to recover preferential transfers of property made by an insolvent debtor within the 90 days before bankruptcy. Section 547(b) serves two important bankruptcy objectives: first, it discourages creditors " 'from racing to the courthouse to dismember the debtor during his slide into bankruptcy' "; and, second, it facilitates " 'equality of distribution among creditors of the debtor.' " *Union Bank v. Wolas*, 502 U.S. 151, 161 (1991) (citation omitted).

Section 547(c) of the Code, 11 U.S.C. § 547(c), creates eight defenses to the preference recoveries otherwise authorized under § 547(b). Among other things, these defenses are "designed to encourage creditors to continue to deal with troubled debtors on normal business terms by obviating any worry that a subsequent bankruptcy filing might require the creditor to disgorge as a preference an earlier received payment." *Barnhill v. Johnson*, 503 U.S. 393, 402 (1992). Two of these defenses are at issue here: the "new value" defense under § 547(c)(1), which protects transfers made as part of a "contemporary exchange for new value given to the debtor," and the "ordinary course of business" defense under § 547(c)(2), which protects transfers "made in the ordinary course of business or financial affairs of the debtor and the transferee."

2. This case concerns transfers made pursuant to a standby letter of credit agreement ("SLCA"), entered into on July 26, 1989, between petitioner Bank One, Milwaukee, N.A. and respondent P.A. Bergner & Co. Pet. App. 2a-3a. The SLCA governed the terms of all standby letters of credit issued by Bank One to secure credit obligations of Bergner to third parties. *Id.* In the SLCA, Bergner agreed to pay Bank One the amount of "any draft

drawn" under any letter of credit "at or before presentation of the draft." Pet. App. 3a. Bergner also agreed, if any specified "event of default" occurred, to pay Bank One "the full amount of all drafts that could be presented" under all outstanding letters of credit. *Id.* In return, Bank One agreed to stand behind Bergner's obligations to pay designated third-party creditors. Pet. App. 6a. These terms are "standard" in standby letter of credit agreements between Bank One and its other customers (Pet. App. 110a) and are "commonly accepted and used in the banking industry" (Pet. App. 120a).[1]

a. Pursuant to its SLCA with Bergner, Bank One issued standby letters of credit to "several" beneficiaries, including the Associated Merchandising Corporation ("AMC"), which supplied inventory to Bergner, and the Liberty Mutual Insurance Company, which provided insurance to Bergner. Pet. App. 3a-4a. The AMC letter of credit was issued in July 1990 and was amended nine times prior to Bergner's bankruptcy; its face value, at all relevant times, was $31,207,000. Pet. App. 5a. Between March 1989 and September 1990, Bank One issued four letters of credit to Liberty Mutual; their total face value, at all relevant times, was approximately $6 million. *Id.*

AMC and Liberty Mutual could draw on their respective letters of credit in either of two circumstances: (1) if Bergner defaulted on an obligation to pay either AMC or Liberty Mutual, the beneficiary could, upon presentation

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[1] In the bankruptcy court, Bergner unsuccessfully sought to exclude from the summary judgment record the important affidavits submitted by Thomas Gaglione (Pet. App. 109a-113a) and James Byrne (Pet. App. 114a-123a). Because this case was decided against Bank One on summary judgment, the testimony in those affidavits must be accepted as true for purposes of the case. *See, e.g., Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 248 (1986).

of appropriate drafts to Bank One, draw down its letter of credit to the extent of the amount payable, Pet. App. 6a; or (2) if Bank One elected not to renew the letters of credit, AMC and Liberty Mutual could draw down the entire face value of their respective letters, regardless of whether Bergner then had any outstanding debt to either beneficiary, Pet. App. 7a-8a. The AMC letter of credit, however, required AMC to make an express promise that, if it drew down the letter of credit when it held no outstanding debt from Bergner, the "proceeds" of the draw would be "held and applied against the obligations of [Bergner] to [AMC] as they come due from time to time." Pet. App. 5a. Similarly, the underlying insurance contract between Liberty Mutual and Bergner made clear that any draw on the Liberty Mutual letters of credit would simply "guarantee performance" of Bergner's obligation to pay insurance premiums (Pet. App. 129a-133a) that were due "on or before the first day of each month" for which Bergner received insurance (Pet. App. 126a). All of these letter-of-credit terms are "standard" in arrangements entered into by Bank One (Pet. App. 110a, 112a) and are "commonly used in the banking industry" (Pet. App. 121a-122a).

b. On May 23 and 24, 1991, Bank One decided not to renew the AMC and Liberty Mutual letters of credit. Pet. App. 7a. Following that decision, AMC and Liberty Mutual decided to draw down the entire amount of their respective letters of credit (Pet. App. 7a-8a), notwithstanding the absence of any debt by Bergner to AMC (Pet. App. 69a) or to Liberty Mutual (Pet. App. 72a) at the time. The decision not to renew a standby letter of credit is "a regular banking practice for Bank One" (Pet. App. 111a) and is also "common" throughout the banking industry (Pet. App. 122a-123a).

On July 19, 1991, Bergner, Bank One, and AMC performed their respective obligations arising out of AMC's draw. In order to fund the draw, as required by the SLCA, Bergner increased its Bank One deposits to $31,207,000. Pet. App. 7a-8a. As required by the AMC letter of credit, Bank One then transferred $31,207,000 to AMC, which in turn "opened up an interest-bearing account in Bergner's favor and credited future orders from Bergner against this account." Pet. App. 18a.

In order to prevent Liberty Mutual's draw, Bergner requested Bank One to issue a replacement standby letter of credit to Liberty Mutual for $6,358,000. Pet. App. 8a. On July 29, 1991, Bank One issued the replacement letter. *Id.* By July 31, 1991, an "event of default" existed; under the SLCA, therefore, Bergner was obligated to maintain sufficient deposits with Bank One to cover any future draws by Liberty Mutual. Pet. App. 8a-9a. On August 23, 1991, following another "event of default" under the SLCA, Bank One exercised its right to hold Bergner's deposits as security for future draws by Liberty Mutual. Pet. App. 9a. Between that date and June 1992, as Bergner's monthly insurance premiums became due, Liberty Mutual drew down the entire $6,358,000. *Id.*

3. On August 23, 1991, Bergner filed a Chapter 11 bankruptcy petition in the United States Bankruptcy Court for the Eastern District of Wisconsin. *Id.* Bergner then commenced an adversary proceeding against Bank One and sought recovery of the $31,207,000 transferred from Bergner to Bank One on July 19 (in turn transferred from Bank One to AMC) and the $6,358,000 transferred from Bergner to Bank One on August 23 (in turn transferred from Bank One to Liberty Mutual). Pet. App. 10a. Bergner argued that the transfers from Bergner to Bank One were avoidable preferences under 11 U.S.C. § 547(b).

Among other things, Bank One responded that the transfers were protected by the "new value" and "ordinary course of business" defenses. The parties filed cross motions for summary judgment.[2]

a. The bankruptcy court granted Bergner's motion for summary judgment and denied Bank One's motion. The court initially held that Bergner had transferred funds to Bank One, which it concluded was not "merely a conduit" for transfers from Bergner to AMC and Liberty Mutual. Pet. App. 76a. The court further held that these transfers had diminished Bergner's estate, and thus constituted avoidable preferences under § 547(b). Pet. App. 76a-90a. The court also rejected Bank One's "new value" and "ordinary course of business" defenses. Pet. App. 92a-101a.

With respect to the "new value" defense under § 547(c)(1), the court reasoned that "*Bank One* did not incur a contemporaneous corresponding obligation to Bergner, which would be necessary for a successful defense." Pet. App. 93a (emphasis added). Addressing the AMC transaction, the court noted that, whereas Bergner intended to pay and did pay Bank One, Bank One "neither intended to transfer anything to Bergner, nor did in fact transfer anything to Bergner," because Bank One's "only obligation was to AMC." *Id.* The court applied a "similar" analysis to the Liberty Mutual transaction. Pet. App. 100a.

With respect to the "ordinary course of business" defense under § 547(c)(2), the court held in pertinent part that Bank One could not satisfy § 547(c)(2)(B), which

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[2] The bankruptcy court had jurisdiction under 28 U.S.C. § 157(b)(1) and (b)(2)(F). The district court had jurisdiction under 28 U.S.C. §§ 158(a) and 1334, and the court of appeals had jurisdiction under 28 U.S.C. §§ 158(d) and 1291.

requires the challenged transfer to be "made in the ordinary course of business or financial affairs of the debtor and the transferee." Applying circuit precedent, the court stated that § 547(c)(2)(B) requires the challenged payment to " 'conform to the norm established *by the debtor and the creditor* in the period before, preferably well before, the preference period.' " Pet. App. 94a, quoting *In re Tolona Pizza Prods. Corp.*, 3 F.3d 1029, 1032 (7th Cir. 1993) (emphasis added). The court thus concluded that § 547(c)(2)(B) could not be satisfied, as a matter of law, because the payments at issue were unusual "as between Bergner and Bank One." Pet. App. 100a-101a.

b. The district court affirmed the grant of summary judgment to Bergner for the reasons stated by the bankruptcy court. The district court held, as a matter of law, that the transfers from Bergner to Bank One were avoidable under § 547(b) (Pet. App. 36a-41a), were unprotected by the "new value" defense under § 547(c)(1) (Pet. App. 42a-45a), and were unprotected by the "ordinary course of business" defense under § 547(c)(2) (Pet. App. 46a-51a).

c. The Seventh Circuit also affirmed the grant of summary judgment to Bergner. The court began by noting that "one can understand Bank One's view of the transactions" as payments from Bergner to AMC and Liberty Mutual, made in exchange for the future provision of goods and services to Bergner. Pet. App. 15a. But the court noted that, under the "independence principle" that governs all letter-of-credit transactions, the debt from Bergner to Bank One (under the SLCA) and the debts from Bank One to AMC and Liberty Mutual (under the letters of credit) were legally independent. Pet. App. 15a-16a. The court concluded that the challenged transfers from Bergner to Bank One had been made on account of "antecedent debt" from Bergner to Bank One, and that

they had "diminished" Bergner's estate. Pet. App. 17a-18a. The court held that the transfers thus satisfied the elements of § 547(b). *Id.*

The court of appeals rejected Bank One's "new value" defense as a matter of law, on the ground that "Bank One *itself* did not incur a contemporaneous corresponding obligation to Bergner." Pet. App. 19a (emphasis added). Addressing the AMC transaction, the court agreed with the bankruptcy court that, whereas Bergner intended to pay and did pay Bank One, *id.* (" 'the only purpose for Bergner's deposit . . . was to pay Bergner's obligation on the letter of credit' ") (citation omitted), Bank One neither intended to pay nor did pay *Bergner*, because "Bank One's obligation ran independently *to AMC*." Pet. App. 19a-20a (emphasis added). The court purported to distinguish *In re Fuel Oil Supply & Terminaling, Inc.*, 837 F.2d 224, 231 (5th Cir. 1988) (*"FOSTI"*), in which the Fifth Circuit previously had held, in the specific context of a letter-of-credit transaction, that "new value received by a debtor need not be provided by the creditor to whom the transfer was made." Finally, the court concluded that "the analysis of the Liberty Mutual transaction is identical in all relevant respects to that of AMC's." Pet. App. 24a.

The court of appeals also rejected Banc One's "ordinary course of business" defense as a matter of law. The court assumed that the challenged payments satisfied the requirements of § 547(c)(2)(A) and § 547(c)(2)(C), but held that these payments could not have been "made in the ordinary course of business" under § 547(c)(2)(B). Pet. App. 21a-22a. Like the bankruptcy court and the district court, the court of appeals focused solely on prior dealings between Bergner and Bank One. The court reasoned that the challenged payments could not have been "made in the ordinary course of business" because "Bergner's

precarious financial situation was the only reason for the chain of events that began in May with Bank One's decision not to renew the AMC and Liberty Mutual letters of credit and culminated in AMC's decision to draw down the full amount of the credit and Liberty Mutual's decision to insist on a new letter." *Id.* (emphasis added). The court thus concluded as a matter of law that, "[w]hile understandable, [Bank One's] actions were not taken in the ordinary course of business as § 547(c)(2)(B) uses that term." Pet. App. 22a.[3]

REASONS FOR GRANTING THE WRIT

The courts of appeals are divided over each of the two questions presented: whether a debtor may receive "new value" under § 547(c)(1) from a party other than the allegedly preferred creditor; and whether the "ordinary course of business" defense under § 547(c)(2) requires the existence of past similar transactions between the debtor, when it was financially healthy, and the allegedly preferred creditor. This Court should grant certiorari because the lower courts are divided, because the decision below severely and improperly restricts the scope of important § 547(c) defenses, and because the decision below, if not promptly corrected, will frustrate fundamental bankruptcy policies both inside and outside the context of letter-of-credit transactions.

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[3] The court of appeals also held that Bergner had standing to maintain this action against Bank One (Pet. App. 10a-14a), that Bank One had failed to establish a preference defense under 11 U.S.C. § 547(c)(4) (Pet. App. 20a-21a), and that Bank One had failed to perfect a security interest in Bergner's deposits prior to the preference period (Pet. App. 22a-24a). The court declined to reach Bergner's alternative contention that the transactions at issue were disallowable setoffs under 11 U.S.C. § 553(b). Pet. App. 25a. None of these rulings is at issue here.

I. THIS COURT SHOULD DECIDE WHETHER A DEBTOR MAY RECEIVE "NEW VALUE" UNDER § 547(c)(1) FROM A PARTY OTHER THAN THE ALLEGEDLY PREFERRED CREDITOR

In rejecting Bank One's § 547(c)(1) defense as a matter of law, the court of appeals did not dispute that, when Bergner made the challenged payments to Bank One (under the SLCA), and when Bank One made substantially contemporaneous payments to AMC and Liberty Mutual (under the associated letters of credit), AMC and Liberty Mutual thereby became obliged (under the AMC letter of credit and the Liberty Mutual insurance contract, respectively) to provide Bergner with future goods and services. Although Bergner thus plainly received new value *from AMC and Liberty Mutual* as a result of these three-way exchanges, the court of appeals rejected Bank One's § 547(c)(1) defense as a matter of law, on the ground that "Bank One itself" did not directly provide the new value to Bergner. Pet. App. 19a.

This Court should review that holding. The decision below is inconsistent with the plain language of § 547(c)(1), which nowhere requires that the allegedly preferred creditor "itself" provide new value directly to the debtor, but instead requires only a "contemporaneous exchange for new value given to the debtor," 11 U.S.C. § 547(c)(1). Four courts of appeals have held, consistent with the broad literal terms of § 547(c)(1), that a debtor may receive "new value" from a party other than the allegedly preferred creditor. The decision below improperly restricts the scope of § 547(c)(1) and, in so doing, eliminates that provision in the important context of three-party transactions.

A. The Decision Below Conflicts With The "New Value" Holdings Of At Least Four Other Courts Of Appeals

Both inside and outside the letter-of-credit context, at least four courts of appeals have held that, under the plain language of § 547(c)(1), a debtor may receive "new value" from a party other than the allegedly preferred creditor. This Court should grant certiorari to resolve the conflict between those decisions and the decision below.

1. In its seminal *FOSTI* decision, the Fifth Circuit held, in the specific context of a three-party letter-of-credit financing arrangement, that "new value received by a debtor need not be provided by the creditor to whom the transfer was made but may be provided by [a] third party." 837 F.2d at 231. In *FOSTI*, the debtor (FOSTI) made allegedly preferential transfers to a trade creditor (Gulf). Gulf in turn released letters of credit issued by certain banks, which in turn released their security interest in FOSTI's property. *See id.* at 228. Citing the principle that "letters of credit include three separate and independent relationships," the district court in *FOSTI* held that " 'new value must be given directly to the debtor by the creditor who received a pre-bankruptcy transfer.' " *Id.* at 229 (quoting district court opinion). The Fifth Circuit disagreed, reasoning that § 547(c)(1) was satisfied "because the Banks' release of FOSTI's collateral offset FOSTI's transfer to Gulf," thus replenishing FOSTI's estate and ensuring that "FOSTI's unsecured creditors were not impaired." *Id.* at 230. Moreover, the Fifth Circuit stated that application of § 547(c)(1) would in no way "compromis[e]" the independence principle underlying state letter-of-credit law, because FOSTI (the debtor) was not seeking to prevent Gulf (the letter-of-credit beneficiary) "from drawing on the letters of credit." *Id.* at 229.

Accordingly, the court held that the three-party transaction satisfied § 547(c)(1) even though FOSTI had made a payment to one party (Gulf) and received new value from another (the banks). *See id.* at 230-31.

The Ninth Circuit twice has held that a debtor may receive new value from a third party. *In re Powerine Oil Co.*, 59 F.3d 969 (9th Cir. 1995), *cert. denied*, 516 U.S. 1140 (1996), involved the same fact-pattern as *FOSTI*: the debtor (Powerine) made an allegedly preferential transfer to a trade creditor (Koch), which in turn released certain letters of credit issued by a bank (First National), which in turn released its security interest in the debtor's property. *See id.* at 973. Quoting *FOSTI*, the Ninth Circuit held that § 547(c)(1) was satisfied because Powerine's transfer to Koch was " 'offset' " by First National's transfer to Powerine, " 'thereby resulting in no depletion to the debtor's estate.' " *Id.*, quoting 837 F.2d at 228. Likewise, in *In re E.R. Fegert, Inc.*, 887 F.2d 955 (9th Cir. 1989), the Ninth Circuit held that § 547(c)(1) was satisfied where the debtor (Fegert) made allegedly preferential transfers to two trade creditors (Coral and Shotwell), but received new value, in the form of released security, from their surety (Seaboard). *See id.* at 958-59 (citing *FOSTI*).

The Third Circuit also has held that a debtor cannot defeat a "new value" defense under § 547(c)(1) through the "fracture" of a three-party transaction "into three separate, distinct and unrelated subtransactions." *In re Kumar Bavishi & Associates*, 906 F.2d 942, 945 (3d Cir. 1990). In *Kumar Bavishi*, the debtor made an allegedly preferential transfer to one creditor, who in turn provided a guarantee necessary to induce a third party to extend credit. *See id.* The Third Circuit rejected the debtor's "convoluted" argument for considering only its initial transfer, noting "the brute fact of financial life" that the third party "would not have lent the money to the

debtor" had the allegedly preferred creditor not provided a personal guarantee. *Id.* Considering the entire overall transaction, the Third Circuit held that § 547(c)(1) was satisfied by the creditor's guarantee and the resulting extension of new credit. *See id.* at 945-46.

Finally, the Eighth Circuit, citing *FOSTI*, *Fegert*, and *Kumar Bavishi*, squarely has held that "a transfer of new value by a third party to the debtor may satisfy the 'new value' requirement of § 547(c)(1)." *In re Jones Truck Lines*, 130 F.3d 323, 327 (8th Cir. 1997). In *Jones*, the debtor employer transferred money to an employee pension fund, which provided benefits to the employees, who in turn continued to work for their employer. *See id.* In holding that § 547(c)(1) was satisfied despite the absence of new value "given *directly*" from the pension fund to the debtor, the Eighth Circuit noted that "[t]here are countless transactions in which a debtor transfers property to a creditor in exchange for contemporary new value provided 'to the debtor' by a third party." *Id.* (emphasis in original).[4]

2. In the decision below, the Seventh Circuit did not seriously attempt to distinguish even *FOSTI*, much less any of its numerous progeny. In a single perfunctory

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[4] The district courts, bankruptcy courts, and commentators also have endorsed these principles. *See, e.g., In re David Schick*, 1998 WL 397849, *5 (S.D.N.Y. July 16, 1998) (debtor received "new value" where discharge of liability "caused a third party to release a secured claim"); *In re Microwave Prods.*, 118 B.R. 566, 572 (Bankr. W.D. Tenn. 1990) ("A tripartite relationship may satisfy the elements of 11 U.S.C. § 547(c)(1)"); 5 *Collier on Bankruptcy* ¶ 547.04[1][c], at 547-46 (15th ed. 1998) ("Payment to a creditor may be exempt from avoidance as a preference if the debtor receives contemporaneous new value from a party other than the creditor.") (citing *FOSTI*).

sentence, the court asserted two purported distinctions of *FOSTI*, neither of which is plausible.

First, the court below stated that the Fifth Circuit in *FOSTI* "was clear that the parties *intended* a third party's acts to provide new value to the debtor." Pet. App. 20a (emphasis in original). But that statement rests on a misreading of *FOSTI*, where the Fifth Circuit stated that the parties' intent was *not* at issue. *See* 837 F.2d at 228 ("FOSTI does not argue" intent). More importantly, it ignores that the requisite intent in this case – for Bergner to receive contemporaneous new value from AMC and Liberty Mutual – is evident on the face of the relevant contracts, and from the parties' performance in conformity with those contracts. As explained above, Bergner was required to pay Bank One (under the SLCA) precisely because Bank One was obligated to pay AMC and Liberty Mutual (under the letters of credit), Pet. App. 3a-4a; and, because Bergner "owed nothing" to AMC and Liberty Mutual at the time of the payments (Pet. App. 69a), AMC and Liberty Mutual in turn became obligated, under the AMC letter of credit (Pet. App. 4a-5a) and the Liberty Mutual insurance contract (Pet. App. 126a, 129a), to hold those payments as advances for the future provision of inventory and insurance to Bergner. The court of appeals could ignore this evidence – and resolve the intent issue against Bank One as a matter of law on summary judgment – only by fracturing the three-party transactions into artificially distinct subtransactions, and thus focusing exclusively on whether "Bank One itself" provided new value to Bergner (Pet. App. 19a). This was contrary to the approaches taken by *FOSTI* and the other courts of appeals.

Second, the Seventh Circuit stated that the independence principle "was not implicated" in *FOSTI* because the payments at issue there "occurred after a letter of

credit had expired." Pet. App. 20a. The court again misread *FOSTI*, where a letter of credit was *released* as part of the three-party exchange of value. *See* 837 F.2d at 228 ("in response to FOSTI's performance, Gulf released the letters of credit and the Banks released FOSTI's collateral, thereby providing FOSTI with new value"). The Fifth Circuit did conclude that "the independence principle would not be compromised" by application of the new value defense, but for the entirely different reason that FOSTI (the debtor) could not prevent Gulf (the letter-of-credit beneficiary) "from drawing on the letters of credit." *Id.* at 229. The same is true in this case: because Bank One's payments to AMC and Liberty Mutual did not transfer any property of Bergner's, Bergner could not prevent AMC or Liberty Mutual from drawing on the letters of credit, and the payments from Bank One to AMC and Liberty Mutual were not voidable preferences under § 547(b). *See, e.g., In re Compton Corp.*, 831 F.2d 586, 589 (5th Cir. 1987); Baird, *Standby Letters of Credit in Bankruptcy*, 49 U. Chi. L. Rev. 130, 154 (1982). Moreover, a holding that Bergner could receive new value indirectly from AMC and Liberty Mutual would in no way undermine that conclusion. Because Bergner could not prevent AMC and Liberty Mutual "from drawing on the letters of credit," the independence principle is no more "compromised" here than it was in *FOSTI*. *See* 837 F.2d at 229. The Seventh Circuit thus committed the identical mistake for which the *FOSTI* district court was reversed: it misused the independence principle to nullify a straightforward application of § 547(c)(1) to transactions involving three-party exchanges. *See id.*

The decision below conflicts with *FOSTI* and its progeny on the question whether a debtor can receive new value from a party other than the allegedly preferred

creditor. The Court should grant certiorari to resolve this important circuit conflict.

B. The Decision Below Improperly Restricts The Scope Of The "New Value" Defense

By effectively eliminating the "new value" defense in the context of three-party transactions, the decision below has substantially restricted the scope of § 547(c)(1). The decision below is inconsistent with the plain language of § 547(c)(1) and with the underlying purposes of preference law. This Court should grant certiorari for these reasons as well.

1. In pertinent part, § 547(c)(1) requires only a "contemporaneous exchange for new value given to the debtor." 11 U.S.C. § 547(c)(1). Nothing in that text restricts the "new value" defense to two-party transactions. On the contrary, the word "exchange" is more than broad enough to encompass three-party transactions such as letter-of-credit financing arrangements. *See, e.g., Webster's Third New International Dictionary* 792 (1976) ("exchange" defined to include "a complex of transactions that results in the actual interchange of goods and services"). Moreover, as the Eighth Circuit explained in *Jones*, construing § 547(c)(1) to require that the debtor receive new value directly from the allegedly preferred creditor "radically alters its plain meaning by inserting a word, 'directly,' that Congress omitted." *See* 130 F.3d at 327. In bankruptcy cases as elsewhere, when "the statute's language is plain, 'the sole function of the courts is to enforce it according to its terms.' " *United States v. Ron Pair Enters.*, 489 U.S. 235, 241 (1989) (citation omitted); *see also Patterson v. Shumate*, 504 U.S. 753, 759 (1992) (courts "must enforce the statute according to its terms"). As *Wolas* makes clear, the court of appeals erred in refusing to apply § 547(c)(1) consistent with its broad literal terms,

and in imposing on that provision a limitation "for which the text provides no support." *See* 502 U.S. at 155.[5]

2. The contrast between § 547(c)(1) and § 547(c)(4) underscores the broad literal scope of the former provision. Section 547(c)(1) requires only a contemporaneous exchange for "new value given to the debtor." By contrast, in referring to the allegedly preferred creditor, § 547(c)(4) requires that "such creditor gave new value" to or for the debtor's benefit.[6] If Congress had intended to restrict § 547(c)(1) to two-party exchanges between the debtor and the allegedly preferred creditor, it could readily have required that "such creditor gave new value" to the debtor as part of a contemporaneous exchange. Its decision not to do so confirms that a third party (in contrast to "such creditor") may provide "new

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[5] One commentator has noted the basic flaw in the "new value" holding of the district court (and, thus, in the identical holding of the court of appeals): although "the Court was undoubtedly influenced by the fact that the value conferred appears to be given by AMC and Liberty and not the Bank," its construction of § 547(c)(1) "is unduly restrictive" because nothing in § 547(c)(1) "places any limitations on what entity actually provides the new value as long as new value is in fact given to the Debtor." Bernstein, *Legislative and Judicial Developments in 1997 – Part I*, 54 Secured Lender 68, 73 (Jan./Feb. 1998).

[6] Section 547(c)(4), 11 U.S.C. § 547(c)(4), protects any transfer

> to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor –
>
> (A) not secured by an otherwise unavoidable security interest; and
>
> (B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor.

value" under § 547(c)(1). *See, e.g., Russello v. United States*, 464 U.S. 16, 23 (1983) ("Where Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion").

3. The decision below also is inconsistent with important policies underlying § 547. As long as the debtor receives contemporaneous new value from *someone* (whether the allegedly preferred creditor or a third party), the transaction does not diminish the estate and is fair to all unsecured creditors, who would have no incentive to dismember the debtor. Thus, the decision below in no way advances the policies underlying § 547(b). *See Wolas*, 502 U.S. at 161. However, by eliminating the "new value" defense in all three-party transactions, the decision below creates substantial disincentives for parties to enter into such transactions with possibly troubled debtors, thus frustrating the policies underlying § 547(c). *See Barnhill*, 503 U.S. at 402.

4. Without considering either the text or the policy objectives of federal bankruptcy law, the court of appeals rejected Bank One's § 547(c)(1) defense on the ground that the "independence principle" underlying state letter-of-credit law purportedly was "implicated." Pet. App. 19a-20a. As explained above, however, application of the "new value" defense would not prevent AMC and Liberty Mutual from drawing on their respective letters of credit, and thus would not undermine the independence principle. The § 547(c)(1) question at issue here, whether Bergner could receive new value from AMC and Liberty Mutual, simply does not affect the question whether a payment from an issuer to a beneficiary is a voidable preference. Moreover, the Seventh Circuit's holding that a

debtor must receive new value from the allegedly preferred creditor is far broader than necessary to accommodate the independence principle, even assuming it were implicated. That holding will have significant ramifications outside the context of letter-of-credit transactions, as evidenced by *Fegert*, *Kumar Bavishi*, and *Jones*. Finally, and most fundamentally, to the extent that there were any conflict between federal bankruptcy law and state letter-of-credit law, the Supremacy Clause obviously would require the latter to yield to the former, and not vice versa. The court of appeals, however, invoked state letter-of-credit law to effectively nullify § 547(c)(1) in the important context of three-party transactions. This Court should grant certiorari to correct the court of appeals' misguided approach and to restore the protection that the "new value" defense appropriately affords to such transactions.

C. The Decision Below Will Impede The Efficient Operation Of Standby Letters Of Credit

The Court should also grant certiorari to preserve the efficient operation of standby letters of credit. The decision below will have significant practical consequences for the use of such letters. As explained above, a letter-of-credit arrangement by definition involves a three-party transaction. By eliminating the "new value" defense for all such transactions, the decision below will substantially increase the bankruptcy risks faced by beneficiaries (as in *FOSTI*) and issuers (as here). In so doing, it will make these transactions both more expensive and less available.

The standby letter of credit is a cornerstone of modern commercial transactions. United States banks have issued more than $220 billion in outstanding standby letters of credit. *See* Kraus, *U.S. Banks' Foreign Lending*

Growing Faster Than Domestic, American Banker, Nov. 20, 1997, at 8. These transactions often provide credit to "buyers whose credit is weak." J. Dolan, *The Law of Letters of Credit* § 1.06, at 1-33 (rev. ed. 1996). Under the decision below, however, it would be foolhardy to extend unsecured credit to such buyers, because issuers could not escape preference challenges even where, as here, they structure their transactions to provide new value to the debtor. If not promptly corrected, the decision below will make such unsecured transactions commercially infeasible.

Nor could parties always avoid this problem through the use of security. The buyers who most often need standby letters of credit – those "whose credit is weak," *see*, J. Dolan, *supra*, § 1.06, at 1-33 – are those least likely to have significant unencumbered tangible assets such as equipment or inventory. Issuers also could seek a perfected security interest in their customers' bank deposits, but doing so could be commercially disruptive. Under state law, a bank typically can perfect such a security interest only by freezing the deposits. Pet. App. 22a-24a. That action would completely frustrate the purpose of the credit itself, to say nothing of the bankruptcy objective of encouraging creditors to "deal with" troubled debtors (*Barnhill*, 503 U.S. at 402), rather than seeking to "dismember" them (*Wolas*, 502 U.S. at 161). Certiorari on the "new value" defense is critical.

II. THIS COURT SHOULD DECIDE WHETHER THE "ORDINARY COURSE OF BUSINESS" DEFENSE REQUIRES THE EXISTENCE OF PAST SIMILAR TRANSACTIONS BETWEEN THE DEBTOR, WHEN IT WAS STILL FINANCIALLY HEALTHY, AND THE ALLEGEDLY PREFERRED CREDITOR

The Court should also consider whether the "ordinary course of business" defense applies in this case. The

contract terms at issue were established more than two years before Bergner's bankruptcy filing. Pet. App. 2a-3a, 9a. Those terms were "standard" in Bank One's dealings with other debtors (Pet. App. 110a-112a) and "commonly" used throughout the industry (Pet. App. 120a-122a). One of those terms allowed Bank One not to renew the AMC and Liberty Mutual letters of credit; that decision also occurred outside the preference period (Pet. App. 7a, 9a), reflected Bank One's "regular" practice with other debtors (Pet. App. 111a), and was consistent with "common" industry practices (Pet. App. 122-23a). Despite these undisputed facts, the courts below rejected Bank One's "ordinary course of business" defense as a matter of law.

Applying settled circuit precedent, the bankruptcy court held that § 547(c)(2) requires the challenged payments to reflect past transactions " 'established *by the debtor and the creditor* in the period before, preferably well before, the preference period.' " Pet. App. 94a, quoting *Tolona Pizza*, 3 F.3d at 1032 (emphasis added). *See also* Pet. App. 100a (challenged payments must have been ordinary "as between Bergner and Bank One"). The court of appeals in turn restricted § 547(c)(2) even further; it held that, even though Bergner and Bank One had established a course of dealing before the preference period, any dealings reflecting Bergner's "precarious financial situation" were legally irrelevant to the "ordinary course of business" analysis. Pet. App. 21a-22a.

This Court should review these holdings. They conflict with the decisions of other courts of appeals, and they are wrong.

A. The Decision Below Exacerbates Two Separate Circuit Splits Regarding The Proper Scope Of The "Ordinary Course Of Business" Defense

1. The lower courts are divided on the question whether the "ordinary course of business" defense can be satisfied only if the payment at issue is consistent with past similar payments from the debtor to the allegedly preferred creditor. Like the court of appeals in this case, several courts have held that § 547(c)(2) is so restricted. *See, e.g., In re Food Catering & Housing, Inc.*, 971 F.2d 396, 398 (9th Cir. 1992) (payment must be "ordinary in relation to past practices between the debtor and this particular creditor"); *Lovett v. St. Johnsbury Trucking*, 931 F.2d 494, 497-98 (8th Cir. 1991) (similar); *WJM, Inc. v. Massachusetts Dep't of Pub. Welfare*, 840 F.2d 996, 1011 (1st Cir. 1988) (similar). The Sixth Circuit, however, has held that a broader inquiry is appropriate. *See In re Finn*, 909 F.2d 903, 908 (6th Cir. 1990).

In *Finn*, the Sixth Circuit held that "a transaction can be in the ordinary course . . . even if it is the *first* such transaction undertaken by the customer." *Id.* (emphasis added). The court explained that past similar transactions between the debtor and the allegedly preferred creditor are not essential to the "ordinary course of business" defense because "every borrower who does something in the ordinary course of her affairs must, at some point, have done it for the first time." *Id.* In particular, the Sixth Circuit held that the "ordinary course of business" defense can apply, even absent past similar transactions between the debtor and the allegedly preferred creditor, "where the transaction would not be out of the ordinary

for a person *in the borrower's position.*" *Id.* (emphasis added).[7]

The district courts in at least two other circuits also follow this approach. In *In re Peterson Distributing, Inc.*, 197 B.R. 919, 925-26 (D. Utah 1996), a district court in the Tenth Circuit held that the "ordinary course of business" defense "does *not* require the existence of pre-preference period relations between" the debtor and the allegedly preferred creditor (emphasis added). And, in *In re Oliver Stores*, 1990 WL 102353, at *9 (D.N.J. June 6, 1990), a district court in the Third Circuit held that the "ordinary course of business" defense can be satisfied even where the payments at issue are "novelties within the history of the relationship between" the debtor and the allegedly preferred creditor. *See also In re Morren Meat & Poultry Co.*, 92 B.R. 737, 740 (W.D. Mich. 1988) ("this Court is not convinced that § [547(c)(2)](B) requires a history of prior dealings as the *sine qua non* in order to afford a transferee the protections of § 547(c)(2)").[8]

2. The courts of appeals also are divided on the question whether § 547(c)(2) focuses only on what is

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[7] *Finn* involved the question whether a debt was "incurred in the ordinary course of business or financial affairs of the debtor and the transferee" under § 547(c)(2)(A). *See* 909 F.2d at 908. The Sixth Circuit's analysis of that question is no less applicable to the question whether a payment was "made in the ordinary course of business or financial affairs of the debtor and the transferee" under § 547(c)(2)(B).

[8] Several bankruptcy courts also have held that the "ordinary course of business" defense does not require the existence of past similar transactions between the debtor and the allegedly preferred creditor. *See, e.g., In re AOV Industries*, 64 B.R. 933, 944 (Bankr. D.D.C. 1986) (§ 547(c)(2) satisfied where creditor "or other creditors like him previously entered into similar transactions with the debtor"); *In re Economy Milling Co.*, 37 B.R. 914, 921-22 (Bankr. D.S.C. 1983) (same).

"ordinary" in transactions involving a healthy debtor or whether the defense also permits consideration of what is "ordinary" in transactions involving debtors in a "precarious financial situation" (Pet. App. 21a). As one court has noted, there is a "conflict in authorities regarding the question of how an industry deals with distressed participants." *In re Carled, Inc.*, 91 F.3d 811, 818 (6th Cir. 1996).

Consistent with the decision below, two courts of appeals have held that the "ordinary course of business" defense is available only where the payments at issue are "ordinary" for financially healthy debtors. In *In re Molded Acoustical Prods., Inc.*, 18 F.3d 217 (3d Cir. 1994), the Third Circuit held that "ordinary business terms" under § 547(c)(2) are "those which prevail in *healthy*, not moribund, creditor-debtor relationships." *Id.* at 227 (emphasis added). Similarly, in *In re Meredith Hoffman Partners*, 12 F.3d 1549 (10th Cir. 1993), *cert. denied*, 512 U.S. 1206 (1994), the Tenth Circuit held that "ordinary business terms" under § 547(c)(2) are "those used in 'normal financing relations': the kinds of terms that creditors and debtors use in ordinary circumstances, when debtors are *healthy*." *Id.* at 1553 (emphasis added).

On the other hand, three courts of appeals have squarely rejected that view. In *In re Roblin Indus.*, 78 F.3d 30 (2d Cir. 1996), the Second Circuit held that "ordinary business terms" under § 547(c)(2) "*must* include those terms employed by similarly situated debtors and creditors facing the same or similar problems. If the terms in question are ordinary for industry participants *under financial distress*, then that is ordinary for the industry." *Id.* at 42 (emphases added). In *In re Jeffrey Bigelow Design Group*, 956 F.2d 479 (4th Cir. 1992), the Fourth Circuit held that a debt on a loan was incurred "in the ordinary

course" under § 547(c)(2) because "[a]n entity encountering *difficult financial times* often seeks loans from reputable financial institutions as part of its workout efforts." *Id.* at 488 (emphasis added). And, in *In re U.S.A. Inns of Eureka Springs, Arkansas*, 9 F.3d 680 (8th Cir. 1993), the Eighth Circuit held that "ordinary business terms" under § 547(c)(2) encompass any "prevailing practice among similarly situated members of the industry *facing the same or similar problems.*" *Id.* at 685 (emphasis added).

3. The judicial confusion reflected in these cases cuts across each element of the "ordinary course of business" defense. Thus, the uncertainty regarding what significance to give past transactions between the debtor and the creditor affects what qualifies as a debt "made in the ordinary course" under § 547(c)(2)(A), *see, e.g., Finn*, 909 F.2d at 908; what qualifies as a payment "made in the ordinary course" under § 547(c)(2)(B), *see, e.g., Peterson*, 197 B.R. at 925-26; and what qualifies as a payment "made according to ordinary business terms" under § 547(c)(2)(C), *see, e.g., In re Molded Acoustical Prods.*, 18 F.3d at 220. Similarly, the uncertainty about whether to determine ordinariness by reference to healthy or troubled debtors affects what qualifies as a debt "made in the ordinary course" under § 547(c)(2)(A), *see, e.g., Jeffrey Bigelow*, 956 F.2d at 488; what qualifies as a payment "made in the ordinary course" under § 547(c)(2)(B), *see, e.g.*, Pet. App. 21a-22a; and what qualifies as a payment "made according to ordinary business terms" under § 547(c)(2)(C), *see, e.g., Roblin*, 78 F.3d at 42.

The pervasiveness of these conflicts is hardly surprising, given the considerable judicial confusion about the respective coverage of each subsection of § 547(c)(2), *see, e.g., In re Milwaukee Cheese Wisconsin, Inc.*, 112 F.3d 845, 847 (7th Cir. 1997); *Molded Acoustical Prods.*, 18 F.3d at 223; *Tolona Pizza*, 3 F.3d at 1031, and the repeated judicial

" 'lamen[t]' " about the absence of any significant guidance in the text or the legislative history of § 547(c)(2), *see, e.g., In re J.P. Fyfe, Inc.*, 891 F.2d 66, 71 (3d Cir. 1989), quoting *WJM*, 840 F.2d at 1011. This Court should grant certiorari to address the specific circuit splits directly implicated in this case and, to the extent possible, to provide much-needed general guidance regarding the proper scope of the "ordinary course of business" defense.[9]

B. The Decision Below Improperly Restricts The Scope Of The "Ordinary Course of Business" Defense

On the merits, the court of appeals erred in holding that the "ordinary course of business" defense requires

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[9] Within the last two years alone, the chaotic state of the "ordinary course of business" defense has inspired an entire cottage industry of critics. *See, e.g.*, Goldberg, *A Sensible Proposal To Amend the Ordinary Course of Business Defense*, 16 Am. Bankr. Inst. J. 14, 14 (1997) ("The ordinary course of business defense is the most frequently invoked defense to a preference claim, and probably has generated more litigation than any other provision of the preference statute."); Gordon & Burnett, *Section 547(c)(2) Ordinary Course Exception*, 102 Com. L.J. 168, 169 (1997) ("legal uncertainty" surrounding § 547(c)(2) "has spawned an overwhelming number of preference actions filed by trustees and debtors against unsecured and undersecured creditors"); Ponoroff & Ashby, *Desperate Times and Desperate Measures: The Troubled State of the Ordinary Course of Business Defense – And What To Do About It*, 72 Wash. L. Rev. 5, 9 (1997) ("The present discordance in the interpretation and application of the ordinary course of business defense suggests that the timing may be propitious to reconsider, yet again, the proper formulation of this controversial preference defense. . . . "); Tabb, *Panglossian Preference Paradigm?*, 5 Am. Bankr. Inst. L. Rev. 407, 418 (1997) ("A large percentage of preference litigation involving trade creditors focuses on the application of the ordinary course of business defense. And that application is uncertain both in terms of the facts and the law.").

the existence of past similar transactions between the debtor and the creditor, let alone past similar transactions when the debtor was still financially healthy. These holdings conflict with the plain language of § 547(c)(2) and will frustrate the general policies of that defense. The Court should grant certiorari because the decision below significantly and improperly restricts the scope of the "ordinary course of business" defense.

1. In *Wolas*, this Court made clear that § 547(c)(2) must be applied consistent with its broad and literal terms, without limitations for which "the text provides no support." 502 U.S. at 155. In unanimously holding that the "ordinary course of business" defense is not limited to payments made on short-term debt, the Court stressed that "[t]he most significant feature of [§ 547(c)(2)] that is relevant to this case is the absence of any language distinguishing between long-term and short-term debt." *Id.* The Court explained that, even if Congress had been concerned only with protecting payments on short-term debt, "[t]he fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning." *Id.* at 158.

The plain language of § 547(c)(2) should be dispositive in this case as well. In pertinent part, the statute applies to payments "made in the ordinary course of business or financial affairs of the debtor *and* the transferee." 11 U.S.C. § 547(c)(2)(B) (emphasis added). Nothing in that text requires the payment to be "ordinary" in transactions *between* the debtor and the creditor. Rather, § 547(c)(2)(B) is obviously satisfied where, as here, the disputed payments "comport with . . . the ordinary course of business as established between the creditor and third parties and the debtor and third parties." *Peterson*, 197 B.R. at 926; *accord, e.g., Morren Meat*, 92 B.R. at

740. Similarly, nothing in § 547(c)(2) requires exclusive consideration of what is "ordinary" when the debtor is financially healthy. The court of appeals erred in engrafting these non-textual limitations onto the broad literal terms of § 547(c)(2). *See Wolas*, 502 U.S. at 155.

2. Moreover, combined with the Seventh Circuit's earlier decision in *Tolona Pizza*, the decision below produces significant gaps in the "ordinary course of business" defense. In *Tolona Pizza*, the Seventh Circuit held that a payment is "made according to ordinary business terms" under § 547(c)(2)(C) only if it is consistent with the range of terms commonly used throughout the relevant market. *See* 3 F.3d at 1033. But in the decision below, the Seventh Circuit held that a payment is "made in the ordinary course of business" under § 547(c)(2)(B) only if it was commonly used in dealings between the debtor and the creditor. Pet. App. 21a-22a. Under the construction of § 547(c)(2) established in these cases, evidence that the challenged payment is "ordinary" in the creditor's dealings with third parties, and in the debtor's dealings with third parties, is completely irrelevant: its focus is too broad to address past transactions between the debtor and the creditor, as required by the Seventh Circuit's construction of § 547(c)(2)(B) in the decision below, and yet too narrow to address transactions throughout the relevant market generally, as required by the Seventh Circuit's construction of § 547(c)(2)(C) in *Tolona Pizza*. The court of appeals has provided no textual or other justification for such an implausible result.

3. The decision below also will frustrate the prime statutory objective of encouraging creditors "to deal with troubled debtors on normal business terms." *Barnhill*, 503 U.S. at 402. Under the court of appeals' holding, the "ordinary course of business" defense is legally unavailable for the first transaction between any particular

debtor and creditor, even if the transaction involves payments that are "ordinary" in the creditor's dealings with third parties and in the relevant market generally. Similarly, the "ordinary course of business" defense is legally unavailable for any transaction or payment reflecting the debtor's "precarious" financial condition (Pet. App. 21a), even if its terms are "ordinary" for debtors in that circumstance. These rules create enormous disincentives for parties considering whether to deal with possibly troubled debtors, thus significantly undercutting the policies behind § 547(c).

4. Finally, the court of appeals erred in holding that the "ordinary course of business" defense can be foreclosed as a matter of law by actions contractually authorized and undertaken outside of the 90-day preference period established under § 547(b). The court focused its analysis on Bank One's assertedly unusual decision "not to renew the AMC and Liberty Mutual letters of credit." Pet. App. 21a. But that decision was contractually authorized two years before Bergner filed for bankruptcy, when Bergner unquestionably was still healthy. As Chief Judge Becker has explained, "the duration of the parties' relationship is logically pertinent to the touchstone of the statutory policies undergirding § 547(c)(2)." *Molded Acoustical Prods.*, 18 F.3d at 224. Moreover, Bank One's decision not to renew the letters of credit itself occurred prior to the preference period. No matter what the circumstances, an action occurring outside the preference period cannot support liability under § 547(b). There is no conceivable reason why, as the court of appeals held in this case, such an action should foreclose defenses under § 547(c).[10]

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[10] Several courts have noted the analytical significance of the preference period for purposes of § 547(c)(2)(B). *See, e.g.*,

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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Mossay v. Hallwood Petroleum, Inc., 1997 WL 222921, *4 (N.D. Tex. Apr. 28, 1997) (comparison of dealings "during the preference period" to "prior" dealings); *In re Schwinn Bicycle Co.*, 205 B.R. 557, 572 (Bankr. N.D. Ill. 1997) (issue is "whether the creditor engaged in any unusual collection activities during the preference period"); *In re El Paso Refinery*, 178 B.R. 426, 440 (Bankr. W.D. Tex. 1995) (comparison of dealings "during the time of the preference period" to "prior" dealings).

APPENDIX

UNITED STATES COURT OF APPEALS
SEVENTH CIRCUIT

In the Matter of P.A. BERGNER & COMPANY, formerly doing business as P.A. Bergner & Company of Illinois, Debtor.

P.A. BERGNER & CO., Plaintiff-Appellee, Cross-Appellant,

v.

BANK ONE, MILWAUKEE, N.A., Defendant-Appellant, Cross-Appellee.

Nos. 96-3879, 96-3937.

Decided April 9, 1998.

Before CUMMINGS, WOOD, JR., and DIANE P. WOOD, Circuit Judges.

DIANE P. WOOD, Circuit Judge.

The proper treatment of standby letters of credit in bankruptcy proceedings is a subject of considerable complexity. In this case, P.A. Bergner & Company was the account party for standby letters of credit that Bank One Milwaukee, N.A. ("Bank One") issued in favor of two beneficiaries. Shortly before Bergner declared bankruptcy, it made certain payments to Bank One to cover the bank's own payments honoring the letters of credit. Bergner now wants to recover those payments, as either voidable preferences under section 547(b) of the Bankruptcy Code, or voidable setoffs under section 553 of the Code. See 11 U.S.C. §§ 547(b), 553. (All statutory citations not otherwise attributed are to the Bankruptcy Code, Title 11.) As a preliminary matter, we must also consider Bergner's standing to assert this action at all, as well as

various defenses to its right to recover those payments. Both the bankruptcy court and the district court found in favor of Bergner, although both refused to award it prejudgment interest. Because of the independence of each part of a letter of credit transaction, and because Bank One cannot rely on the argument that it had a perfected interest at the critical time in the funds it used to cover its payments to the beneficiaries of the letters of credit, we agree with the district court that the payments in question were voidable preferences and affirm. On Bergner's cross-appeal from the denial of prejudgment interest, we find that the denial was an abuse of discretion and remand for a determination of the appropriate amount of interest to award Bergner.

I

Bergner (now known as Carson Pirie Scott & Co.) is the holding company for a number of large retail department stores, principally located in the Midwest. At the time the events at issue here began to unfold Bank One was Bergner's primary cash management bank. It handled Bergner's primary operating account, and it also issued standby letters of credit in substantial amounts to entities with which Bergner did business, including suppliers and insurers. Bergner did not rely primarily on Bank One for credit; instead, it maintained a revolving line of credit with a group of mostly European banks led by the Swiss Bank Corporation (collectively, "the Swiss bank group").

On July 26, 1989, Bergner and Bank One entered into a Standby Letter of Credit Agreement ("SLCA") under

which Bank One agreed to issue standby letters of credit as security for some of Bergner's credit obligations. This general agreement was to govern the terms of all irrevocable standby letters of credit Bank One might issue for Bergner. Under section 1, Bergner promised to pay Bank One the amount of any draft drawn under a letter of credit issued pursuant to the SLCA "at or before presentation of the draft" by the letter's beneficiary. If an "event of default" occurred, Bergner was obligated to pay Bank One the full amount of all drafts that could be presented under outstanding letters of credit, which sum Bank One would hold without interest for the purpose of honoring such drafts. Section 6 of the SLCA gave Bank One "a security interest in and lien on any deposit account or other money now or hereafter owed [Bergner] by [Bank One]." Bergner also agreed that Bank One could, "at any time after the occurrence of an Event of Default, without prior notice or demand set off against any such accounts or other money, all or part of the unpaid balance of the Obligations." Section 12 directed that the SLCA was to be governed by the laws of the State of Wisconsin, and that letters of credit issued under it were to be interpreted according to whatever version of the Uniform Customs and Practice for Documentary Credits (UCP) published by the International Chamber of Commerce was in effect at the time of the issuance of that letter.

At Bergner's request, Bank One issued standby letters of credit, under the SLCA, to several beneficiaries, two of which are relevant to this action: one of Bergner's suppliers, Associated Merchandising Corporation ("AMC"), and Bergner's insurance company, Liberty Mutual Insurance Company. These letters, like all letters

of credit, had three relevant parties – the account party, or applicant (Bergner, the bank's customer), the issuer (Bank One), and the beneficiaries (AMC and Liberty Mutual). The relationship between each pair of parties involved in a letter of credit transaction is entirely independent, although each relationship is necessary to support a letter of credit, somewhat like the three legs of a tripod. See generally John F. Dolan, *The Law of Letters of Credit: Commercial and Standby Credits* ch. 2 (rev. ed.1996).

The first leg of our tripod – the agreement between Bank One and Bergner – was a contractual relationship, represented here by the SLCA we have already described. The letters of credit themselves, which embodied the direct arrangement between the issuer (Bank One) and the beneficiaries (AMC and Liberty Mutual) were the second leg. Third, of course, Bergner had distinct obligations to the beneficiaries that the standby letters of credit were designed to secure.

Bank One's letter of credit notifying AMC that Bergner had established an irrevocable standby credit in its favor was typical. That letter specified the documents AMC would need to present in order to draw on the credit, set forth a number of special conditions, and specified that the letter was subject to the 1983 version of the UCP, Int'l Chamber of Commerce Pub. No. 400. The AMC letter of credit contained a so-called "evergreen" clause, see Dolan, *The Law of Letters of Credit*, at G-12 (Glossary), under which, upon expiration, it would automatically be renewed for one year unless Bank One provided at least 60 days notice of nonrenewal. The bank also promised that if it sent such a notice, AMC would have the following right:

> [A]fter such notice is given . . . funds under this Letter of Credit will also be available against a sight draft drawn on us by AMC, accompanied by a signed written statement on its letterhead stating:
>
> > "The proceeds of the accompanying draft will be held and applied against the obligations of CPS Department Stores, Carson Pirie Scott & Co. and/or P.A. Bergner & Co. of Illinois to The Associated Merchandising Corporation as they come due from time to time".

The AMC credit was first issued on July 31, 1990, for a face amount of $31,000,000. It was amended nine times to reflect increases or decreases in the amount of Bergner's outstanding orders with AMC. By July 2, 1991, the amount of the credit was $31,207,000, and the expiration date was July 31, 1991.

Between March 1989, and September 1990, Bank One also issued four letters of credit at Bergner's request to Liberty Mutual. These too were irrevocable standby letters governed by the 1983 Revision of the UCP. Taken together, their initial face amount totaled $7,097,803, but as of July 1991, they totaled $5,836,725 and were also due to expire on July 31. (There is some slight ambiguity in the record as to the total value of the Liberty Mutual letters at this later date – both the parties and we are relying on poor photocopies – but this number seems most supportable and the exact figure is irrelevant.) The letters of credit in Liberty Mutual's favor allowed for payment upon presentation of a draft attached to a signed statement that the draft was for sums payable to

Liberty Mutual; they did not include the special draw-down provision included in AMC's letter.

Bergner needed standby letters of credit to provide added security for its contract to purchase merchandise from AMC and for its insurance policy with Liberty Mutual. Bank One's irrevocable standby letters of credit served that purpose. The effect of standby letters of credit like these is to put the issuer (Bank One) itself behind the account party's (Bergner's) promises to pay. As long as Bergner paid those with which it contracted, the standby letters of credit did not come into play. If, however, one of the events entitling a beneficiary to draw on a letter of credit occurred, then the beneficiary was entitled to go straight to Bank One to collect its money, without worrying about Bergner's financial health. Bank One, in turn, promised to honor a demand from either beneficiary that conformed to the letters of credit, no matter what defenses Bergner may have had against either AMC's or Liberty Mutual's request for funds. A bank is willing to make such promises to a beneficiary both because its customer – the account party to the transaction – pays it a fee for the service (approximately $300,000 annually in this case), and because the bank is in the best position to ensure that the account party will be good for the money. Sometimes the bank may simply trust a long-time customer to reimburse the bank if a beneficiary draws on a letter of credit, but very often the bank will either demand collateral or, as Bank One did here, require its customer to prepay the bank in the amount of any demand that the beneficiary may present. See generally Dolan, *The Law of Letters of Credit* ¶¶ 1.04-1.06.

On May 23 and 24, 1991, Bank One sent certified letters both to its account party, Bergner, and to the two beneficiaries of the letters of credit, AMC and Liberty Mutual, announcing that it would not renew those letters of credit. This action prompted AMC to inform Bergner that it was planning to exercise its rights, under the special condition detailed above, to draw down the full amount of the credit in its favor. Bergner passed this word along to Bank One on July 16, 1991, which prompted Bank One to ask Bergner how it planned to prefund the AMC draw. Bank One suggested one possibility – that Bergner borrow the money from Bank One itself – but Bergner rejected this on the ground that the interest rate offered was unattractive. Bergner instead turned to the revolving line of credit it maintained with the Swiss bank group, which at that time was still approximately $74 million, believing that the interest rate would be more favorable. Bergner informed Bank One that it would make sure that it had enough money on deposit with Bank One before the AMC draw, as it was required to do under the SLCA.

On July 17, 1991, AMC presented documents to Bank One to try to draw down the full amount of the letter of credit. Those documents proved to be nonconforming, which bought the parties a brief amount of time. After correcting the technical problems with the documents, on July 19, 1991, AMC submitted conforming documents and drew $31,207,000 under the letter of credit. At 11:02 a.m. that day, the Swiss bank group wired $31,000,000 through the Federal Reserve Bank to Bergner's general operating account at Bank One (which already had enough to cover the remaining $207,000). At 1:24 p.m., Bank One began

the process of transferring the funds from Bergner's operating account to AMC by "memo posting" Bergner's account in the amount of $31,207,000. "Memo posting" is a provisional internal bank process to record the transaction pending formal posting at the end of the day. At 2:10 p.m. Bank One transferred the full $31,207,000 through the Federal Reserve Bank to AMC.

Meanwhile, Liberty Mutual was also taking action in light of Bank One's earlier notification that its letters of credit would not be renewed. On July 22, 1991, it too notified Bank One that it intended to draw down its letters unless it received a replacement letter of credit. At Bergner's request, on July 29, 1991, Bank One replaced the expiring Liberty Mutual letters of credit with a new letter of credit in the amount of $6,358,000. (The new letter allowed draws on it only after July 31, the date the four old Liberty Mutual letters were scheduled to expire, and did expire, by their own terms.) Bergner's economic problems were becoming worse, however. On July 23, 1991, Bergner had presented its revised liquidity projections to the Swiss bank group, which was not impressed. On July 29, 1991, Bergner made another draw request on its revolving Swiss bank group credit facility. The next day, the Swiss bank group told Bergner that it would not honor the July 29 request, and it declared a "material adverse change" under its credit agreement with Bergner. This action had the effect of making unavailable the approximately $43 million that remained after the July 17 draw of $31,000,000 under the facility.

On July 31, Bergner notified Bank One that the Swiss bank group had declared a "material adverse change"

under its credit agreement with Bergner. Bank One considered this an "event of default" under the SLCA, and told Bergner that it would start exercising its rights under the SLCA to offset letter of credit draws against Bergner's other accounts, unless Bergner maintained sufficient funds on deposit with Bank One to collateralize the full amount of the new Liberty Mutual letter of credit. (The offsetting procedure would have meant that large numbers of Bergner's ordinary checks would have been dishonored.) Although Bergner was not able to comply with this demand instantly, after August 2, 1991, it maintained at least enough in its account to cover the new Liberty Mutual letter of credit.

These measures were not enough to stabilize Bergner's financial position. On August 23, 1991, Bergner told Bank One that it intended to file a petition under Chapter 11 of the Bankruptcy Code. This too was an event of default under the SLCA. Bank One exercised its rights under section 6 of the SLCA by taking $6,358,000 from Bergner's account and placing it in a collateral account under Bank One's control, allocating these funds for any future claims by Liberty Mutual under the outstanding letter of credit in its favor. That same day, Bergner filed its Chapter 11 petition in the bankruptcy court for the Eastern District of Wisconsin.

By June 10, 1992, Liberty Mutual had drawn down the entire amount of its letter of credit from Bank One. On August 11, 1992, Bergner (now as the Chapter 11 debtor in possession) demanded from Bank One the return of $30,007,558.79, which represented an improvement in Bank One's position for the AMC letter of credit obligation, and $5,680,475, which represented an

improvement in its position for the Liberty Mutual letter of credit obligation, citing § 553(b) of the Bankruptcy Code. Bank One refused, and on August 26, 1992, Bergner commenced the present adversary proceeding to recover as preferential transfers both its July 19, 1991, payment of $31,207,000 to cover AMC's letter and the August 23, 1991, attachment of Bergner's cash deposits in the amount of $6,358,000. Bergner alleged that it was entitled under 11 U.S.C. § 550 to recover these amounts for two reasons: first, the payments were preferential transfers made within 90 days of the debtor's petition for bankruptcy, see 11 U.S.C. § 547(b), and second, the trustee or the debtor in possession is entitled to recover a creditor's attempted setoff of a debt within 90 days prior to the filing of the petition, see 11 U.S.C. § 553(b). (It also argued other grounds of recovery initially, but these are not before us.) Both the bankruptcy court, *In re Bergner*, 187 B.R. 964 (Bankr.E.D.Wis.1995), and the district court (in an unpublished opinion) ruled in Bergner's favor.

II

At the threshold, Bank One attacks the judgment against it by arguing that Bergner has no standing to assert the present action. Under the Bankruptcy Code, the debtor must specifically identify in its reorganization plan the claims it wishes to pursue postconfirmation. See 11 U.S.C. § 1123. Bank One argues that the plan must use "specific and unequivocal" language to accomplish this result, and that Bergner's plan failed to do so. We find this argument unpersuasive. As Bergner points out, at the time its plan was confirmed it had been prosecuting the present action against Bank One for over fourteen

months. The parties had produced hundreds of documents and eighteen volumes of deposition testimony had been amassed. Discovery continued after confirmation, with not a peep from Bank One. This was undoubtedly because the plan contained the following language:

> 13.3. *Avoidance and Recovery Actions.*
>
> Effective as of the date of the approval of the Disclosure Statement by the Bankruptcy Court, the Debtors waive the right to prosecute and release any avoidance or recovery actions under sections 544, 545, 547, 548, 549, 550, 551, and 553 of the Bankruptcy Code or any other causes of action, or rights to payments of claims, that belong to the Debtors or the Debtors in Possession, *other than any such actions that may be pending on such date.*

(Emphasis added.) Section 15.1(b) of the plan made it clear that the bankruptcy court retained jurisdiction to hear any such adversary proceedings that survived confirmation.

We agree with the bankruptcy court and the district court that the plan language just quoted was sufficient to preserve this proceeding for purposes of § 1123. That section allows plans to provide for:

> (A) the settlement or adjustment of any claim or interest belonging to the debtor or to the estate; or
>
> (B) the retention and enforcement by the debtor . . . of any such claim or interest. . . .

11 U.S.C. § 1123(b)(3). The language of § 1123(b)(3)(B) is broad enough to encompass both those situations where a debtor is trying to preserve a potential future claim about

which the affected party had no notice and the subset of claims that have already been filed (and are thus a matter of public record) but that remain unresolved. The Bank One action was pending as of the date of the reorganization plan, and Bank One was actively engaged in litigating it. While there might be some logic in requiring "specific and unequivocal" language to preserve claims belonging to the estate that have never been raised, the statute itself contains no such requirement. The courts that have spoken of the need for "specific" and "unequivocal" language have focused on the requirement that plans unequivocally retain claims of a given type, not on any rule that individual claims must be listed specifically. *E.g., In re Harstad,* 155 B.R. 500, 510 (Bankr.D.Minn.1993) (plan must specifically state that preference actions are retained), *aff'd,* 39 F.3d 898 (8th Cir.1994); *In re Mako,* 120 B.R. 203, 209 (Bankr.E.D.Okla.1990). The language of Bergner's plan provided all the notice to which Bank One was entitled under the statute to preserve the ongoing proceeding between the parties. See, *e.g., In re Acequia, Inc.,* 34 F.3d 800, 807-08 (9th Cir. 1994). We therefore conclude that Bergner's reorganization plan does not preclude the present action.

Bank One also makes a related argument, to the effect that any recovery in this action will no longer redound to the benefit of Bergner's estate, and thus the action must be dismissed for that reason. It is true that the Bankruptcy Code does not permit the avoidance of a preferential transfer unless the recovery would be for the benefit of the estate. See 11 U.S.C. § 550(a). It is also true that benefit to the creditors of the estate, rather than to the debtor alone, is necessary for recovery under § 550(a). *See*

Harstad v. First American Bank, 39 F.3d 898, 905 (8th Cir.1994); 5 Lawrence P. King, *Collier on Bankruptcy* ¶ 550.02[2] (1997). Bank One argues that because the unsecured creditors in Bergner's case have already recovered on their claims – at the agreed rate of thirty-three cents on the dollar – there is no way they could benefit from a recovery in the present case. Recovery by reorganized Bergner, it correctly notes, will only benefit the new owners of reorganized Bergner, which Bank One argues does not satisfy the statute.

Bank One errs in its belief that recovery to the creditors of Bergner must be direct. See *Harstad*, 39 F.3d at 905; 5 *Collier on Bankruptcy* ¶ 550.02[2] n. 9 at 550-7; *In re Acequia, Inc.*, 34 F.3d 800, 811 (9th Cir.1994) ("Courts construe the 'benefit to the estate' requirements broadly, permitting recovery under section 550(a) even in cases where distribution to unsecured creditors is fixed by a plan of reorganization and in no way varies with recovery of avoidable transfers."). Here, we agree that recovery will benefit the owners of reorganized Bergner. But who are they? Under the plan, 100% of the equity in Bergner was distributed to the holders of the Swiss bank group's approximately $300 million in undersecured claims, who in exchange funded $25 million of the distribution to general unsecured creditors. Recovery in this preference action will benefit reorganized Bergner, as Bank One points out, which in turn will benefit the owners of reorganized Bergner – the largest creditor group of old Bergner. This is enough, in our view, to satisfy the requirements of § 550. *See In re Acequia, Inc.*, 34 F.3d at 811; *In re Trans World Airlines, Inc.*, 163 B.R. 964, 969-71 (Bankr.D.Del.1994). A contrary holding would be

in serious tension with the right of the debtor under § 1123 to continue pursuing claims after plan confirmation, as that right would mean little if it could be defeated by showing that recovery would not go to the original creditor group in its original form.

III

With those preliminary questions out of the way, we turn to the central issue on this appeal: did the courts below correctly find that Bergner's payments to Bank One to cover the AMC and Liberty Mutual transactions were voidable preferences under § 547(b), which were not eligible for either the new value or ordinary course of business exceptions of § 547(c)? Bank One argues that the lower courts should not have followed the independence principle that normally governs letter of credit transactions under the circumstances presented here, because in reality in AMC's case there was only a single economic transaction orchestrated by Bergner, in which it moved $31,000,000 from its Swiss bankers, through Bank One, to AMC; in Liberty Mutual's case, Bank One argues, there was no diminution of Bergner's estate because the debit of $6,358,000 was inexorably tied to an equal credit in Bank One's "collateral account," and eventually to payments to Liberty Mutual. Bank One urges us to find that these transactions had no effect at all on the debtor's estate, and it argues that Bergner would receive a windfall if the debtor's estate were permitted to recoup the payments made to the bank. Bergner responds that Bank One's position ignores the independence of each part of the letter of credit transaction from each other part. If we were to follow Bank One's position, Bergner claims, we

would be doing serious violence to the common business understanding of letters of credit and to the usefulness of the device in commercial transactions.

At first blush, one can understand Bank One's view of the transactions. Looking first at the AMC letter of credit, Bank One claims it was just a collection agent for Bergner. It points out that its SLCA with Bergner required Bergner to prefund all draws before Bank One would pay anything, from which it reasons that the money just flowed through the bank, much as this court described a transaction not involving a letter of credit in *Bonded Financial Services, Inc. v. European American Bank*, 838 F.2d 890, 896 (7th Cir.1988). Bank One concedes that its position is not consistent with the independence principle that underlies letter of credit law, but it asks us not to "overemphasize" that principle so as to ignore the economic reality of a transaction for purposes of preference analysis.

The only problem with Bank One's argument is that letters of credit really are different from other financing mechanisms, and Bank One's position does not reflect the independent obligations that ran from the bank to the beneficiaries. From the point of view of the beneficiaries, AMC and Liberty Mutual, the way that Bank One settled its accounts with Bergner was of no importance, either legal or practical. As soon as Bank One issued the irrevocable letters in favor of each beneficiary (for a fee, as Bergner reminds us), it assumed the obligation of paying upon a draft supported by documents that conformed to the terms of the credit. Thus, when AMC presented its draft with conforming documents to Bank One on July 19, 1991, Bank One was required to pay AMC the full

$31,207,000 that the letter of credit then provided, whether or not Bergner gave it a red cent. If Bergner did not comply with its own agreement with Bank One, under which it was required to give the bank the amount of the draw either before or at the time of the payment to the beneficiary, then Bank One would have had a perfectly good contract action against Bergner, but it would have had no defense against honoring the beneficiary's demand. See *In re Slamans*, 69 F.3d 468, 475 (10th Cir.1995); UCP, Int'l Chamber of Commerce Pub. No. 400, Art. 3, 16 (1983); Dolan, *The Law of Letters of Credit* ¶¶ 7.05[1], 2.01-2.02.

This means that at the moment AMC presented its draft, a debt arose between Bergner (as debtor) and Bank One (as creditor), in the amount of the requested draft. (This would not have been the case if, for example, AMC had demanded payment directly from Bergner, and Bergner had asked the bank to issue a cashier's check; in that situation the bank would have incurred no obligation to AMC if it had refused to write the check without sufficient funds from Bergner to cover it.) The debt was due, according to the SLCA, no later than the time when Bank One was required to honor the draft under its letter of credit to AMC. In order to pay its debt to Bank One, Bergner arranged for the transfer of $31,000,000 from the Swiss bank group to its account at Bank One. (Even though the time periods were quite short, as a result of the speed at which wire transfers can be accomplished through the Federal Reserve System, the underlying character of the transactions was no different than if these transfers had taken place over a period of weeks rather than hours or minutes.) Once Bergner placed the required

amount of money in its account at Bank One, it authorized Bank One to take that money in satisfaction of its obligation under the SLCA, which Bank One did first by making its "memo posting," and later in the day by formally posting the transfer from Bergner to itself.

Still focusing on the AMC transaction, unless the existence of section 6 of the SLCA (under which Bergner gave Bank One a "security interest in and lien on any deposit account or other money now or hereafter owed [Bergner] by [Bank One]") alters the analysis, this breakdown of the transaction shows that Bergner indeed had a debt to Bank One, and that Bank One assured itself of payment in full within the preference period identified by § 547(b). Looking at the elements of § 547(b) (again putting to one side the question whether Bank One should be viewed as a secured creditor), we agree with Bergner that Bank One obtained a preferential transfer: there was a transfer in the amount of $31,207,000 of Bergner's funds to Bank One; the transfer was made on account of Bergner's antecedent obligation *under the SLCA* to pay Bank One the amount of a draw under the AMC letter of credit; the transfer was made while Bergner was insolvent; it occurred within ninety days of Bergner's filing its petition under Chapter 11; and the transfer allowed Bank One to be paid in full, even though other unsecured creditors would not have received full payment in a liquidation of Bergner.

Bank One's three main arguments for why this payment is not avoidable under § 547(b) – that there was no transfer, that the transfer was not on account of an antecedent debt, and that Bergner's estate was not diminished by the transfer, in the sense of *In re Smith*, 966 F.2d

1527, 1535 (7th Cir.1992) – all in the end are nothing more than an attempted recharacterization of the transaction and an attack on the independence principle, neither of which we find persuasive. The discrepancy between the amount due to AMC under its letter of credit ($31,207,000) and the amount Bergner borrowed from the Swiss bank group to help cover AMC's draw ($31,000,000), while small, further illustrates the flaw in Bank One's position. Bergner paid Bank One $31,207,000 to fulfill its debt to Bank One; the source of $31,000,000 of that amount is no more important than the source of the remaining $207,000. The entire amount was Bergner's money at the pertinent time, which it used to pay a debt it owed to Bank One, its creditor.

Bank One attempts to avoid this logic in three ways: First, it argues that the new value exception of § 547(c) prevents the debtor from avoiding the preferential transfer. Next it argues that the transfers cannot be avoided because they were accomplished in the ordinary course of business, also a defense under § 547(c). Finally, it may be arguing that there were no avoidable transfers because it had preexisting perfected security interests in the monies it acquired.

Bank One's new value argument does not hold up under careful inspection. Focusing only on what *AMC* did with the money once it obtained it, Bank One points out that AMC (as it was required to do under the letter of credit) opened up an interest-bearing account in Bergner's favor and credited future orders from Bergner against this account. In Bank One's view, this shows that the debtor's estate was not depleted by the alleged preferential transfer: instead of the $31,000,000 represented

by part of its credit line with the Swiss bank group, Bergner instead initially received $31,000,000 in credit from AMC, eventually replaced by merchandise of an equal value. Bank One suggests that section 547(c)(1) of the Bankruptcy Code, which reads as follows, was designed for just this situation:

> (c) The trustee may not avoid under this section a transfer –
>
> (1) to the extent that such transfer was –
>
> (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
>
> (B) in fact a substantially contemporaneous exchange.

(The term "new value" means "money or money's worth in goods, services, or new credit, or release by a transferee of property previously transferred to such transferee. . . . " 11 U.S.C. § 547(a)(2).)

The bankruptcy court rejected Bank One's argument for the straightforward reason that "[t]he only purpose for Bergner's deposit, which both parties knew would be swept up by the bank, was to pay Bergner's obligation on the letter of credit; there is no evidence Bergner intended by the deposit to purchase a credit balance at AMC." *In re Bergner,* 187 B.R. at 979. Furthermore, the bankruptcy court continued, Bank One itself did not incur a contemporaneous corresponding obligation to Bergner at the time it seized the funds, which would be necessary for the new value defense to succeed. Bank One's obligation

ran independently to AMC, and it satisfied that obligation by paying AMC. *Id.* Like the district court, we find this reasoning sound. Bank One was not entitled to use the new value defense to defeat the debtor's recovery of the amount it paid to Bank One as a result of the AMC letter. Bank One can argue that Bergner obtains a windfall only by ignoring the independence principle. Bank One had no legally recognizable interest in what AMC did with the money or how its actions related to its dealings with Bergner. Bergner paid $300,000 for Bank One's promise to pay its supplier or insurance company whenever those parties presented conforming documents, and thus Bank One gave Bergner what was in effect a contingent loan (in the amount of the payments due to the beneficiaries) by issuing this letter. "Many bankers have rued the day they issued a standby letter of credit without assessing and treating it as a true loan or without taking solid collateral as security." 3 James J. White & Robert S. Summers, Uniform Commercial Code § 26-1(b) at 110 (4th ed.1996).

Last, we note that *In re Fuel Oil Supply & Terminaling, Inc.*, 837 F.2d 224 (5th Cir.1988) ("*FOSTI*") is not to the contrary – the court there was clear that the parties *intended* a third party's acts to provide new value to the debtor, and the independence principle was not implicated in that case, since the payments at issue occurred after a letter of credit had expired by its own terms with no payment made under that letter of credit. See *FOSTI*, 837 F.2d at 228. Bank One's alternative new value defense, under § 547(c)(4), fails as well, for both the above reasons and since Bank One gave no subsequent

unsecured credit which remained unpaid. See *In re Prescott*, 805 F.2d 719, 728 (7th Cir.1986); 5 *Collier on Bankruptcy* ¶ 547.04[4].

The ordinary course of business defense is no more helpful to Bank One. As this court noted in *In re Milwaukee Cheese Wisconsin, Inc.*, 112 F.3d 845, 847 (7th Cir.1997), there are three requirements for that defense, each of which must be satisfied. The transfer must be:

> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
>
> (B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and
>
> (C) made according to ordinary business terms[.]

Milwaukee Cheese, 112 F.3d at 847, quoting 11 U.S.C. § 547(c)(2). In *Milwaukee Cheese*, we held that a "sudden payment in full of all debts in a discrete category, in anticipation of bankruptcy and for the purpose of helping a favored class of creditors, is the paradigm of a preference." *Id.* So here, even if the debt that Bergner incurred to Bank One arose in the ordinary course of business through the parties' longstanding SLCA, and even if (stretching things a bit) the payment was made according to ordinary business terms, we cannot find that the transfer was made in the ordinary course of the debtor's business. Indeed, it is clear that Bergner's precarious financial situation was the only reason for the chain of events that began in May with Bank One's decision not to renew the AMC and Liberty Mutual letters of credit and

culminated in AMC's decision to draw down the full amount of the credit and Liberty Mutual's decision to insist on a new letter. Events of default under the SLCA were occurring, which led to Bank One's efforts to protect its position. While understandable, its actions were not taken in the ordinary course of business as § 547(c)(2)(B) uses that term.

Although it is somewhat unclear from the briefs, Bank One may also be arguing that it had a perfected security interest in Bergner's deposit accounts at the bank, thus preventing avoidance. While this is the normal route for banks to avoid losses in bankruptcy when they pay beneficiaries under standby letters of credit, see James A. Rodenberg, *Letters of Credit in Bankruptcy: Can the Independence Doctrine Survive Preference Attacks?* 96 Com. L.J. 431, 452 (1991), Bank One had no security interest that could have helped it in these circumstances. Bank One is correct that section 6 of the SLCA granted it a security interest in Bergner's deposits in the bank. It argues that when it "memo posted" Bergner's account at 1:24 p.m. on July 19, it effectively froze the account and took control of the funds, which perfected its security interest. It concedes that a consensual security interest in a deposit account is outside the scope of Article 9 of the UCC, § 9-104(*l*), see Wis. Stat. § 409.104, but it argues that Wisconsin would recognize a common law security interest in the deposit account and that such a security interest is perfected by the bank's assumption of control over the account. (It cites only New York cases for this proposition, see *Gillman v. Chase Manhattan Bank, N.A.*, 73 N.Y.2d 1, 537 N.Y.S.2d 787, 534 N.E.2d 824 (1988); *Miller v. Wells*

Fargo Bank Int'l Corp., 540 F.2d 548 (2d Cir.1976); Wisconsin courts seem not to have addressed the issue, except as to the general rule that cash proceeds may be traced to deposit accounts. See *Commercial Discount Corp. v. Milwaukee Western Bank*, 61 Wis.2d 671, 214 N.W.2d 33 (1974).) Bergner counters that Bank One itself admitted that it did not assume control over Bergner's account until the end of the day, after it had paid AMC. The memo posting, by Bank One's own description, was not a "freeze" that might have perfected its lien, but rather just a "temporary record of the wire transfer" out of the account to AMC. Bergner also argues that the "memo posting" was not enough to satisfy the requirements of common law lien perfection, under which the secured bank must maintain exclusive access to the account and actually restrict depositor access by seizing the account or retaining an indispensable instrument like a passbook.

According to Dean Douglas Baird's leading article on standby letters of credit in bankruptcy, the question whether a bank can enforce its security interest in collateral after it honors a customer's letter of credit depends upon when the security interest attached and was perfected under state law. If attachment and perfection under state law take place more than ninety days before bankruptcy, the bank's security interest should prevail over the trustee's effort to set aside the transfer as a voidable preference, even if the bank does not assert control over the collateral until some time within the preference period. See Douglas G. Baird, *Standby Letters of Credit in Bankruptcy*, 49 U. Chi. L. Rev. 130, 149-51 (1982); see also *Fidelity Financial Services, Inc. v. Fink*, ___ U.S. ___, 118 S.Ct. 651, 139 L.Ed.2d 571 (1998) (holding that a

creditor may invoke the "enabling loan" exception to the trustee's power to avoid a preferential transfer only by satisfying state law perfection requirements within the twenty-day period provided by 11 U.S.C. § 547(c)(3)(B)). Here, of course, Bank One did not assert control over Bergner's account until some time on July 19; prior to that time, Bergner had unrestricted access to funds in the account and could withdraw them at will. Thus, even if we assume that Bank One's actions were enough to perfect a common law security interest in Bergner's account, perfection did not occur until well within the ninety day preference period. "The transfer of the debtor's property takes place when the collateral is perfected by the issuing bank, not when the issuing bank makes payment under the letter." Rodenberg, *Letters of Credit in Bankruptcy*, 96 Com. L.J. at 452; *In re Compton Corp.*, 831 F.2d 586, 591 (5th Cir.1987). Under these circumstances, the bank's security interest does not survive the attack of the trustee or the debtor in possession. Cf. *In re Powerine Oil Co.*, 59 F.3d 969, 973-74 (9th Cir.1995) (to the extent an issuer was not secured preferences in its favor could be avoided).

We note finally that the analysis of the Liberty Mutual letter of credit is identical in all relevant respects to that of AMC's, even though Liberty Mutual did not draw on the letter until long after the petition for bankruptcy protection had been filed. By August 23, Bergner had an existing obligation to Bank One under the SLCA for $6,358,000; Bank One took steps to gain full control of the funds on deposit to cover Bergner's obligations under the SLCA on the very day Bergner filed its Chapter 11 petition – obviously within the ninety day preference period. The substitution of the new letter of credit for the

old series of letters makes no difference, at least in any way that would help Bank One's position. (The record reflects that Bank One issued the new letter because Liberty Mutual otherwise would have drawn down the full amount to which it was eligible under the four older letters; it was thus in Bank One's own interest to issue this new letter, regardless of any effect on Bergner.) For the same reasons that we rejected the new value and ordinary course of business defenses with respect to the AMC letter, they are of no help to Bank One for the Liberty Mutual letter.

Bank One's actions seizing for itself both the $31,207,000 that Bergner paid it in satisfaction of Bergner's debt under the SLCA, and the $6,358,000 to assure its ability to collect from Bergner an amount equal to the new Liberty Mutual letter of credit were therefore avoidable preferential transfers under § 547(b), which Bergner is entitled to recover under § 550(a). In light of this conclusion, we have no occasion to reach the question whether the same transactions might also be viewed as setoffs subject to disallowance under 11 U.S.C. § 553(b)(1).

IV

Last, Bergner has raised on cross-appeal the question whether the district court abused its discretion when it refused to award prejudgment interest to Bergner. The bankruptcy court denied prejudgment interest to Bergner on the ground that it would have amounted to a windfall under the circumstances, because it was unlikely that Bergner would have had use of the money after the

transfer in any event. The unsecured creditors might have received more than thirty-three cents on the dollar, but Bergner would not have seen any more money. *In re Bergner,* 187 B.R. at 984. The district court found that this was not an abuse of the bankruptcy court's discretion and affirmed.

We agree that the standard of review here is for abuse of discretion, see *Milwaukee Cheese,* 112 F.3d at 849, but we see an inconsistency between the lower courts' treatment of the value of the funds to Bergner in this context with their analysis (with which we have agreed) of Bergner's standing to bring this suit at all. The new owners of Bergner, recall, are the largest class of unsecured creditors of the firm. Prejudgment interest on the award would benefit them, just as recovery of the preferential transfers will benefit them. As the lower courts recognized, prejudgment interest should not be thought of as a windfall in any event; it is simply an ingredient of full compensation that corrects judgments for the time value of money. See *Milwaukee Cheese,* 112 F.3d at 849. The district court implied that it had some discomfort with the bankruptcy court's result, and we share that view. Indeed, because "[d]iscretion must be exercised according to the law, which means that prejudgment interest should be awarded unless there is a sound reason not to do so," *id.*, we conclude that it was an abuse of discretion, based on the failure to recognize Bergner's status as the successor to the creditors' claims, not to make prejudgment interest a component of Bergner's judgment. We therefore reverse that part of the district court's judgment and remand for purposes of

calculating the proper amount of interest to add to the judgment.

For the foregoing reasons, we AFFIRM the judgment of the district court in all respects except for its decision not to award prejudgment interest to Bergner. We REVERSE and REMAND for the limited purpose of allowing the district court to amend its judgment to include the appropriate amount of interest in its award. Costs on appeal are to be taxed against Bank One.

UNITED STATES DISTRICT COURT
EASTERN DISTRICT OF WISCONSIN

P.A. BERGNER & CO.,

Plaintiff/Appellee,

v.

BANK ONE,
MILWAUKEE, NA,

Defendant/Appellant.

Case No. 95-C-1087

DECISION AND ORDER

* * *

Bank One, a prepetition creditor, appeals from the bankruptcy court's decision granting summary judgment to P.A. Bergner (Bergner), the debtor in possession, in this adversary proceeding for recovery of an avoidable preference or setoff.

Bergner (now known as Carson Pirie Scott & Co.) filed a voluntary petition under Chapter 11 on August 23, 1991. Bergner's reorganization plan was confirmed on October 15, 1993, and payments under the plan were completed soon thereafter. General unsecured creditors received $0.33 on the dollar, and the class of creditors that purchased Bergner's debt to Swiss Bank received equity in the reorganized entity. The plan provided that the debtor retained the right to prosecute any pending preference actions on its own behalf, and the bankruptcy court previously held this provision gave the postconfirmation entity standing to continue the action. Bergner withdrew its claims regarding letters of credit issued by Bank One, with two exceptions: those benefitting

Bergner's supplier, Associated Merchandising Corporation (AMC), and Bergner's insurance carrier, Liberty Mutual Insurance Company (Liberty).

I. BACKGROUND

Bergner is a holding company for a number of large department stores. Bergner's primary operating account was located in Bank One. Bank One issued letters of credit in substantial amounts to AMC and Liberty, as well as other entities with which Bergner did business.

On July 26, 1989, Bank One and Bergner entered into a Standby Letter of Credit Agreement (the SLOC Agreement), the master agreement under which Bank One would issue standby letters of credit (SLOCs) to be paid only if Bergner failed to pay directly amounts owed the beneficiaries or if any other event of default occurred. The SLOC Agreement required that Bergner pay Bank One amounts drawn on a letter of credit before such amounts were paid by Bank One, but payment did not affect Bank One's obligation to the beneficiary. The SLOC Agreement was automatically renewable (unless Bank One elected not to renew, in which case Bank One was required to give beneficiaries sixty days' notice), a so-called "evergreen" agreement. Under the SLOC Agreement, Bank One had a security interest in funds on deposit with Bank One, but no other collateral for a debt that might arise in connection with a draw. Standard letters issued to AMC and Liberty provided that if Bergner failed to pay outstanding amounts due, Bank One was obligated to AMC and Liberty up to the amount of the letter of credit.

A. The AMC Letter of Credit

AMC, a cooperative buying association of department stores, is the purchaser of goods manufactured primarily in Pacific Rim countries. Retailers order goods, and AMC contracts with its suppliers for the manufacture of the goods, making its own financial arrangements with the manufacturers. Goods are invoiced to AMC's buyers as soon as they are shipped, and payment is due within forty-eight hours.

In 1989, AMC required a SLOC to cover the possibility of its not being paid for goods on order to Bergner. Bank One provided a SLOC, which was amended nine times as orders fluctuated. When AMC finally drew on the letter, the amount outstanding was $31,207,000. Ninety days before filing, the amount was over $37,000,000. Until the transfer which Bergner seeks to avoid, Bank One had never paid on a SLOC issued to AMC.

On May 23, 1991, Bank One notified Bergner by letter that it would not be renewing its letter of credit. Bank One likewise notified AMC. At that time, Bergner and Bank One knew that AMC was entitled to draw on the letter of credit, notwithstanding the fact that Bergner owed nothing to AMC at the time. Anticipating a draw on its obligation to AMC, Bank One demanded that Bergner deposit $31,000,000 in its account at Bank One.

On July 19, 1991, AMC presented conforming documents to draw on the letter of credit (AMC had presented nonconforming documents two days earlier). At that time, Bergner had at least $207,000 in its Bank One

account. At 11:02 a.m., Bergner deposited $31,000,000 in its Bank One account, which it had acquired by drawing on its revolving line of credit with its Swiss Bank lenders. At 11:15 a.m., Bank One notified Bergner that it had received the funds. At 1:24 p.m., Bank One "memo posted" Bergner's account for the $31,207,000 to be sent to AMC – in effect, Bank One froze the account, preventing Bergner from using the funds for any purpose other than to fund the AMC wire. At 2:11 p.m., Bank One transferred $31,207,000 to AMC's account at Hong Kong Shanghai Bank via Bank One's account at the Federal Reserve, thus giving Bergner a credit balance at AMC for goods not yet shipped. At the end of the day, Bank One debited Bergner's account for the amount transferred to AMC. Bank One's internal "Standby Letter of Credit General Ledger Account" (which records outstanding SLOCs for which Bank One might be held liable in the future) was credited for the payment. Except for the initial deposit in Bergner's Bank One account, all of the pertinent activity in the account on July 19, 1991 was initiated by Bank One.

Thirty-five days later, Bergner filed under Chapter 11. Bergner owed Bank One nothing on its AMC letter of credit obligation. AMC continued to ship goods to Bergner, and most of the credit balance was consumed by postpetition shipments.

B. The Liberty Letter of Credit

Liberty held a letter of credit under the same SLOC Agreement as AMC, which covered charges for past insurance coverage. On May 24, 1991, Bank One notified

Liberty that it would not renew Bergner's letter of credit when it expired on July 31, 1991, at which time Liberty would be entitled to draw approximately $5,800,000. On July 29, 1991, however, Bank One agreed to issue a new letter of credit for $6,358,000, thus allowing Bergner to continue its insurance coverage and avoiding an immediate draw by Liberty. The new letter of credit provided that it could be drawn on only after July 31, 1991, so that Bank One's obligation to Liberty and Bergner's letter of credit coverage were uninterrupted.

Two days after issuing the new letter of credit, Bank One learned that Bergner's relationship with Swiss Bank had deteriorated. By letter dated July 31, 1991, Bank One demanded that Bergner keep at least $6,400,000 in its account to cover the Liberty letter of credit. Bergner agreed to maintain the required balance, but in fact, on August 2, 1991, the account was overdrawn. After August 2, 1991, and until it filed for bankruptcy, however, Bergner maintained a balance in excess of $6,400,000. Except for the minimum-balance requirement, Bank One did not restrict Bergner's account or dishonor Bergner's checks.

On August 23, 1991, Bergner informed Bank One that it intended to file for bankruptcy. Bank One immediately debited Bergner's account by $6,358,000 and notified Bergner that it had setoff the account in the amount of the Liberty letter of credit. The funds were deposited in Bank One's "Cash Letter of Credit Account," an account kept on Bank One's books for its outstanding letters of credit, and commingled with other bank funds in the account. When Bergner filed its petition later that same day, no debt was owed Bank One on account of the Liberty letter

of credit. The Cash Letter of Credit Account was debited from time to time as Liberty drew on the letter postpetition.

C. The Bankruptcy Court's Decision

In this action, Bergner sought to recover the prepetition transfers of $31,207,000 and $6,358,000 to Bank One. Bank One and Bergner each moved for summary judgment on the issue of whether Bergner could recover a preference under 11 U.S.C. § 547 or a setoff under 11 U.S.C. § 553(b) for the payments made by Bergner to Bank One for draws on letters of credit issued to AMC and Liberty. The bankruptcy court granted Bergner's motion for summary judgment and denied Bank One's motion, determining that Bergner is entitled to recover both payments as a matter of law.

After reciting the undisputed facts, the bankruptcy court first determined that Bergner had satisfied its burden of proof to show by a preponderance of the evidence that each of the five elements of an avoidable preference existed with regard to the draws made on both the AMC and Liberty letters of credit. 11 U.S.C. § 547(b). It then determined that Bank One had failed to establish each of the defenses it raised. Finally, the bankruptcy court denied prejudgment interest to Bergner.

II. ANALYSIS

Bank One alleges six errors on the part of the bankruptcy court:

1. Whether the Bankruptcy Court erred in requiring Bank One to pay Bergner's new owners more than $31,000,000 as an avoidable preference, based on Bank One's wire to AMC of $31,207,000 of funds from Bergner's account, which was depositied in advance for such purpose, and which created a deposit later used by Bergner to buy $31,207,000 worth of goods.

2. Whether the Bankruptcy Court erred in finding an avoidable preference based on Bank One's requirement of security for the new extension of credit to Bergner by the Liberty Mutual letter of credit, or based on Bank One's later segregation of that collateral, particularly in view of subsequent benefit derived by Bergner from the payment of insurance premiums with such funds.

3. Whether the Bankruptcy Court erred when it held that Bergner's new owners had the right to pursue the causes of action asserted against Bank One, despite evidence that any recovery will not benefit Bergner's estate, but instead to inure solely to the benefit of the new owners, and that Bergner's Plan of Reorganization did not unequivocally retain such causes of action.

4. Whether the Bankruptcy Court erred in finding voidable setoffs under Section 552(b) of the Bankruptcy Code, despite lack of evidence establishing either (i) mutual, matured obligations between Bank One and Bergner, or (ii) Bank One's alleged intention to effect an offset, or (iii) conduct or documentation evidencing an offset.

5. Whether the Bankruptcy Court erred when it failed to find any genuine issue of material fact regarding whether, as a result of the AMC or Liberty transaction, (i) Bank One received more than it would have in a Chapter 7 case, as required by Section 547(b)(5) of the Bankruptcy Code, and (ii) recovery by Bergner would provide it with more than a single satisfaction contrary to Section 550 of the Bankruptcy Code.

6. Whether the Bankruptcy Court erred when it held that the transactions between Bank One and Bergner were not made in the ordinary course of business under Section 547(c)(2) of the Bankruptcy Code when it was undisputed that all parties performed in complete conformity with their contractual obligations and consistently with the practice in the industry.

Appellant Br. at 1-2. Additionally, Bergner filed a cross appeal arguing that the bankruptcy court erred in denying prejudgment interest.

A. Whether the AMC and Liberty Transfers are Avoidable Preferences

Bank One contends that the transfers of funds from Bergner's account on July 19, 1991 (to cover the AMC letter of credit) and on August 23, 1991 (to cover the Liberty letter of credit) were not avoidable preferences for several reasons. First, Bank One argues, Bergner's estate was not diminished when the funds were transferred. Second, the transfers were not made on account of an antecedent debt owed. Third, Bank One's argument continues, Bank One had valid defenses, namely that

Bergner received new value and that the transfers were made in the ordinary course of business.

1. Diminution of Bergner's Estate

The first component of Bank One's argument is that no interest in property of Bergner's was transferred, *see* 11 U.S.C. § 547(b), by the debit for the AMC letter of credit because Bergner acquired a corresponding asset, namely a credit balance with AMC. Similarly, Bank One argues that because the debit for the Liberty letter of credit was used to pay Liberty's insurance premiums, Bergner received the full benefit of the funds and its estate was not diminished. Thus, the argument goes, Bank One was merely a conduit for the movement of funds, Bergner's assets were not diminished by the transactions, and accordingly, there was not a transfer in Bergner's interest in property to be avoided on either occasion.

As the bankruptcy court noted, a number of cases have interpreted the introductory paragraph of section 547(b) ("[T]he trustee may avoid any transfer of an interest of the debtor in property. . . . ") as a requirement that the debtor's estate be diminished by the transfer sought to be avoided. Without expressly adopting that interpretation of section 547(b), the bankruptcy court determined that Bergner's property was diminished by each of the transfers at issue:

> If diminution in the debtor's property is a separate requirement for preference recovery, and this court is by no means certain that it is, the transfers from Bergner's account meet this

> requirement. To determine whether the transfer diminished the debtor's property, it is useful to examine what property the debtor would have had at filing absent the transfer. Here, the debtor would have had the cash in its accounts, including $37,565,000 for the two debits. It would also have had whatever accrued to it by virtue of Bank One honoring the letters of credit, for which Bergner had paid substantial consideration. Bank One intimates that it might not have paid its obligations on the letters, a remarkable posture for a reputable bank to take. Nevertheless, the bank is correct that Bergner is not a third party beneficiary of the letters, and Bergner could not compel compliance on the beneficiaries' behalf. This merely underscores the independence of Bank One's obligation to AMC and Liberty and Bergner's obligation to Bank One. *See in re Security Services, Inc.*, 132 B.R. 411, 414-15 (Bankr W.D. Mo. 1991); *Matter of Val Decker Packing Co.*, 61 B.R. [831,] 837-39 [(Bankr. S.D. Ohio 1986)]. However, even if Bank One had successfully evaded its obligations under the letters of credit, the substantive difference between having unrestricted cash of $37,565,000 and having credits of $37,565,000 that can be used only for one supplier, AMC, and for one insurance carrier, Liberty, is significant enough to constitute diminution of the debtor's property.

Op. at 16-17.

Bank One argues that the bankruptcy court "failed to properly assess whether or not Bergner's estate was diminished by the transfer of funds to AMC." It contends that the court's analysis "should have centered on whether the transfer of Bergner's assets from its Bank

One account to the credit deposit at AMC reduced Bergner's estate." Appellant Br. at 14.

"[T]o the extent a deposit is made into an unrestricted checking account, in the regular course of business and withdrawable at the depositor's will, it is not avoidable by the trustee." *In re Prescott*, 805 F.2d 719, 729 (7th Cir. 1986). On the other hand,

> If the deposit is accepted by the bank with an intent to apply it "on a pre-existing claim against the depositor rather than to hold [it] subject to the depositor's checks in ordinary course," . . . the deposit is viewed legally as a transfer in payment of the debt. As such, it may be recovered by the trustee where the elements of a voidable preference are otherwise satisfied.

Prescott, 805 F.2d at 729 (quoting *Miller v. Wells Fargo Bank Int'l Corp.*, 406 F. Supp. 452, 467 (S.D.N.Y. 1975), *aff'd*, 540 F.2d 548 (2d Cir. 1976)) (alterations in original).

Contrary to Bank One's criticisms, the bankruptcy court properly determined that to the extent diminution of the estate is required under Seventh Circuit law, *see in re Smith*, 966 F.2d 1527 (7th Cir.), *cert. dismissed, Baker & Schultz, Inc. v. Boyer*, 506 U.S. 1030 (1992), the facts of this case satisfy that requirement. It is undisputed that Bank One effectively froze Bergner's account, thus removing the $31,207,000 from Bergner's control, and then transferred the funds to AMC on its own initiative, without any direction from Bergner. That shift in control over the funds from Bergner to Bank One constitutes a diminution in Bergner's estate and thus a transfer. Bergner's resulting lack of control over the funds, as well as the exchange

of unrestricted funds for a credit at AMC, clearly constitute a diminution in Bergner's estate. The same analysis applies to the Liberty transaction. Bank One took control over the funds in Bergner's account and shifted the funds to its own account. The fact that the funds were used by Bank One to pay Liberty's insurance premiums does not preclude a diminution in Bergner's estate.

2. Antecedent Debt Owed

Bank One also argues that the transfers of funds to AMC and Liberty do not constitute avoidable preferences because the transfers were not made "on account of an antecedent debt owed," as required by 11 U.S.C. § 547(b)(2). Because Bergner's reimbursement obligation to Bank One was contingent until Bank One paid on, rather than was presented with, a conforming draw, Bank One argues, the transfer was not a payment made on an antecedent debt owed.

The bankruptcy court rejected this argument first with regard to the AMC transfer:

> Bank One argues it was only a contingent creditor of Bergner, and a contingent creditor cannot hold an antecedent debt within the meaning of 11 U.S.C. § 547(b)(2). On the contrary, contingent debts are also antecedent debts within the meaning of 11 U.S.C. § 547(b)(2). *See, e.g., Matter of Milwaukee Cheese,* 164 B.R. (297,) 305 [(Bankr. E.D. Wis. 1993)]; *Matter of Val Decker Packing Co.,* 61 B.R. at 841. Cases cited by the bank, such as *Matter of Wey,* 854 F.2d 196 (7th

Cir. 1988), are distinguishable. In *Wey*, the transfer sought to be avoided was the forfeiture of a down payment that occurred when the debtor could not complete a sale. The court stated that a debt does not arise until there is a legal obligation to pay, and the debtor was not obligated to pay until closing. There was no debt until his breach, which extinguished his interest in the down payment previously transferred. The breach resulted in no transfer as well as no antecedent debt. This is distinguishable from cases such as *Milwaukee Cheese*, in which the liability for payment was certain, but the timing of the payment or the happening of an additional event was uncertain.

In this case, events had developed to a point of certainty that made Bank One no longer a contingent creditor. The letter was not to be renewed, which was an event of default. Moreover, AMC had drawn on its letter. This meant that when Bergner's account was seized, Bergner's debt to Bank One had matured and was payable. The agreement between Bergner and Bank One required payment before the draw, not reimbursement after the draw; thus the money was already owed to Bank One when the debit from Bergner's account occurred. The obligation sought to be avoided was not a prepayment to AMC; it was payment on a mature obligation of Bergner to Bank One. This satisfies the requirement that the transfer was on account of an antecedent debt owed by the debtor before the transfer was made. . . .

Op. at 21-22.

Under the terms of the parties' SLOC Agreement, Bergner was obligated to pay Bank One "the amount of

any draft drawn under, or purporting to be drawn under, a Credit," with payment due "at or before presentation of the draft." AMC presented conforming documents to draw on the letter of credit on July 19, 1991, and had presented nonconforming documents two days earlier. Thus, no later than July 19, 1991, Bergner was obligated to pay Bank One. As the bankruptcy court determined, AMC's draw triggered Bergner's obligation to pay Bank One under the SLOC Agreement. Accordingly, the transfer was made on account of an antecedent debt owed by Bergner before the transfer was made.

The bankruptcy court also determined that the Liberty transfer was on account of an antecedent debt: "Liberty had a right to draw on the letter because of Bergner's insolvency and bankruptcy, and such a draw was a virtual certainty. Under the letter of credit agreement, payment by Bergner was required before Liberty drew, not after, which made the debt no longer contingent." Op. at 26. Despite the fact that Liberty had not drawn on the letter, Bergner's insolvency, under the terms of the SLOC Agreement, transformed the debt from contingent to antecedent. Likewise, then, the Liberty transfer was made on account of an antecedent debt owed by Bergner before the transfer was made.

3. Bank One's Defenses

a. New Value – Bank One argues that the resulting AMC credit and the payments on Liberty's insurance premiums constitute "new value," rendering the transfers unavoidable under 11 U.S.C. §§ 547(c)(4) and 547(c)(1).

Section 547(c)(1) provides an exception to avoidable preferences to protect transactions intended to be a contemporaneous exchange for new value:

> (c) The trustee may not avoid under this section a transfer –
>
> (1) to the extent that such transfer was –
>
> (A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and
>
> (B) in fact a substantially contemporaneous exchange. . . .

Section 547(c)(4) provides that a transfer "to or for the benefit of a creditor" is unavoidable "to the extent that, after such transfer, the creditor gave new value to or for the benefit of the debtor" which was "not secured by an otherwise unavoidable security interest" and "on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor." "New value" is defined in 11 U.S.C. § 547(a)(2) as "money or money's worth in goods, services, or new credit, or release" of property previously transferred, provided the previous transfer is not itself avoidable.

The bankruptcy court first determined that with regard to the AMC transfer, "[n]o transaction constituting a contemporaneous exchange for new value occurred when Bank One seized the Bergner bank account":

> the only purpose for Bergner's deposit, which both parties knew would be swept up by the bank, was to pay Bergner's obligation on the

> letter of credit; there is no evidence Bergner intended by the deposit to purchase a credit balance at AMC. Nothing in the affidavits presented by the bank supports any other purpose for the payment/deposit but to pay Bergner's obligation to Bank One.
>
> More importantly, upon seizure of the funds when the transfer occurred, Bank One did not incur a contemporaneous corresponding obligation to Bergner, which would be necessary for a successful defense under 11 U.S.C. § 547(c)(1). The bank's only obligation was to AMC, which it paid. The bank neither intended to transfer anything to Bergner, nor did it in fact transfer anything to Bergner at the time of the seizure. Therefore, there was no contemporaneous exchange for new value.

Op. at 30-31.

Bank One maintains that the evidence indicates that it intended to transfer new value to Bergner in the form of the AMC credit. I disagree. The evidence supports the conclusion that the parties intended to fulfill their obligations under the SLOC Agreement and the AMC letter of credit – nothing else.

With regard to the Liberty transaction, Bank One argues that the "new" Liberty letter of credit issued on July 29, 1991, constituted new value. The bankruptcy court disagreed, finding that it was merely a renewal of the old expired letter of credit:

> This court is satisfied that, except for the $500,000 increase in the amount payable to Liberty, the issuance of the new letter merely took the place of the old letter. Issuance of the new

letter continued the obligation of Bank One to Liberty uninterrupted, and it prevented a draw under the old letter, a significant benefit to Bank One. The new letter was "substituted for an existing obligation" of Bank One to Liberty as that term is used in 11 U.S.C. § 547(a)(2), and it is not new value. In any event, whether the issuance of the new letter is new value relates to Bank One's obligation to Liberty, not Bergner's obligation to Bank One. Only the latter is the subject for recovery in this action, and whether the seizure satisfied Bergner's obligation to Bank One for a new or reissued letter of credit is irrelevant.

The decisive question is, if there was an exchange for new value, what was the *new* contemporaneous consideration that Bank One gave Bergner in exchange for the money seized? There was none, as Bank One had already obligated itself to pay Liberty when each letter of credit was issued. *Matter of Compton Corp.*, 831 F.2d (586,) 590 [(5th Cir. 1987)]; *In re Security Services, Inc.*, 132 B.R. [411,] 414 [(Bankr. W.D. Mo. 1991)]. Thus, the analysis of the debit of Bergner's account on August 23, 1991, for the Liberty letter of credit is similar to the analysis for AMC. The debit was intended to reduce Bergner's obligation to Bank One, not to create a credit on Bank One's books for application to future insurance charges, because on August 23, 1991, Bergner had no obligation to pay Liberty for either a debt or as a prepayment for future services.

Therefore, neither the issuance of the July 29, 1991 letter of credit nor the subsequent seizure of Bergner's account to pay Bank One for

> future draws on the Liberty letter of credit were contemporaneous exchanges for new value within the meaning of 11 U.S.C. § 547(c)(1).

Op. at 37-38.

I agree with the bankruptcy court's analysis. Whether Bank One chose to renew Liberty's letter of credit or pay a draw on the letter of credit, it was not furnishing new value to Bergner's estate. By virtue of the SLOC Agreement, Bergner already had obtained a letter of credit for Liberty that was "evergreen." Thus, the "new" letter of credit merely took the place of the old letter of credit. As the bankruptcy court reasoned, substituting one obligation for another is not "new value." *See In re Security Servs., Inc.*, 132 B.R. 411, 414 (Bankr. W.D. Mo. 1991).

The bankruptcy court also rejected Bank One's defense under section 547(c)(4):

> This subsection, 11 U.S.C. § 547(c)(4), was raised by the bank but is inapplicable to the facts. This defense requires that after the transfer, the creditor gave new value to the debtor, and the new value was not paid for ("on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor"). 11 U.S.C. § 547(c)(4)(B); *Matter of Century Brass Prod., Inc.*, 71 B.R. 77, 78-79 (Bankr. D. Conn. 1987). Bank One was paid in full before filing, so there was no new value given by Bank One after the transfer for which it was unpaid.

Op. at 35-36. Using the same reasoning, the bankruptcy court determined that section 547(c)(4) likewise was inapplicable to the Liberty transfer: "The obligation was not

unpaid at the time of filing, as is required for application of this defense." Op. at 40.

Despite Bank One's criticism of the bankruptcy court's "short hand" approach to section 547(c)(4), the court's determination is in line with the Seventh Circuit's decision in *Prescott*. There, the court recited the three requirements for a section 547(c)(4) defense: "Section 547(c)(4) establishes a subsequent advance rule whereby a preferential transfer is insulated from a trustee's avoiding powers to the extent that a creditor extends new value, which is unsecured and remains unpaid, to a debtor *after* the preferential transfer." *Prescott*, 805 F.2d at 728 (quoting *In re Saco Local Dev. Corp.*, 30 B.R. 859, 867 (Bankr. D. Me. 1983)). The court went on to hold that because the creditor "never showed that any overdrafts went unpaid," it had failed to meet its burden of proof in establishing this defense. *Prescott*, 805 F.2d at 728.

The same analysis prevents Bank One from establishing the defense here. It is undisputed that Bank One was paid in full before Bergner filed for bankruptcy. Accordingly, I agree with the bankruptcy court that section 547(c)(4) is inapplicable to both the AMC and Liberty transfers.

b. Ordinary Course of Business – Bank One also argues that the trial court erred in determining that the AMC transfer was not made in the ordinary course of business under 11 U.S.C. § 547(c)(2).

Section 547(c)(2) precludes the trustee from avoiding a transfer "to the extent that such transfer was":

> (A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;
>
> (B) made in the ordinary course of business or financial affairs of the debtor and transferee; and
>
> (C) made according to ordinary business terms . . .

The bankruptcy court determined that Bank One met the first requirement of the defense, that the debt be incurred in the ordinary course of business. However, the court determined that Bank One had not met the second and third requirements:

> The second requirement is that the debt be paid in the ordinary course of the business affairs of the debtor and creditor. This defense was intended to leave normal business relations undisturbed and to avoid transfers brought about only by unusual actions taken by the debtor or creditor that resulted in a creditor obtaining a relatively better position than other similarly situated creditors. *See In re Energy Coop., Inc.*, 832 F.2d 997, 1004 (7th Cir. 1987), citing legislative history. In *Matter of Tolona Pizza Products Corp.*, 3 F.3d 1029, 1032 (7th Cir. 1993), the court required that for a creditor to be protected from having to disgorge a prepetition transfer, the transfer or payment should "conform to the norm established by the debtor and the creditor in the period before, preferably well before, the preference period." While transactions need not occur often to be found in the ordinary course, the same court said "a creditor asserting § 547(c)(2) must show that the debtor incurred its debt and paid the creditor in ways

similar to other transactions." *In re Energy Coop., Inc.*, 832 F.2d at 1004 (citations omitted).

This court's colleague in *Matter of Milwaukee Cheese Wisconsin, Inc.*, 164 B.R. 297, 307 (Bankr. E.D. Wis. 1993) (citations omitted), identified four tests to examine the circumstances surrounding the challenged payment. Each test might be probative of the parties[']prior relationship in determining what was ordinary for the parties. These are particularly illuminating when applied to the undisputed facts in this case:

> "(1) whether the transfer was in an amount more than usually paid." Neither party suggested there was a prior payment by Bergner that even approached $31,207,000, and this court will boldly characterize this as an unusually substantial amount.
>
> "(2) whether the payments were tendered in a manner different from previous payments." There is no allegation that Bank One had ever involuntarily seized Bergner's bank account for payment of an obligation.
>
> "(3) whether there appears to be any unusual action by either the debtor or creditor to collect or pay the debt." This factor is most telling. Bergner borrowed $31,000,000 from Swiss Bank to make the deposit, and Bank One seized the funds. Before doing so, Bank One had cancelled the letter of credit, thereby precipitating the event of default. This was not standard conduct of the parties.

"(4) whether the creditor did anything to gain an advantage in light of the debtor's deteriorating financial condition." Involuntary seizure of a bank account gave the bank a significant advantage over other creditors.

The third element of the 11 U.S.C. § 547(c)(2) defense is that the payment be made according to ordinary business terms. This requires inquiry into "the range of terms that encompasses the practices in which firms similar in some general way to the creditor in question engage, and that only dealings so idiosyncratic as to fall outside that broad range should be deemed extraordinary and therefore outside the scope of subsection c." *Matter of Tolona Pizza Prod. Corp.*, 3 F.3d at 1033. The bank's officer, Thomas Gaglione, stated in his affidavit that it was within the ordinary course of the business of banks issuing standby letters of credit to refuse to renew those letters on expiration, to demand payment of drafts, and to ask customers how they wish to pay for the drafts. Such practices may be common in the banking industry. However, he also stated in his deposition, "No one expects a standby letter of credit to be drawn."

Conspicuously absent from Mr. Gaglione's affidavit is any assertion that Bergner gave instructions for debiting the account. The involuntary seizure of funds in an account may be something banks commonly do to protect their legal rights. However, there was no assertion by Bank One or its experts that such a seizure is a common industry practice during the ongoing letter of credit relationship or at its ordinary termination.

> This is simply not the sort of transaction intended to be protected by 11 U.S.C. § 547(c)(2); it is precisely the type of "idiosyncratic" exercise of creditor muscle that 11 U.S.C. § 547 was designed to avoid. *Matter of Tolona Pizza Products,* 3 F.3d at 1033.
>
> Although a deposit to a bank account can be a transfer to the bank, unrestricted bank accounts usually are considered funds of the depositor. *Matter of Prescott,* 805 F.2d at 729. Banks cannot deal with those funds without the permission of the depositor except in unusual circumstances, usually related to the debtor's precarious financial circumstances. Nothing in Bank One's submissions of proof has alleged that banks ordinarily take control over depositors' accounts, even when the depositor has a loan outstanding, as was done here.
>
> Therefore, the seizure of Bergner's account and payment to itself for the AMC wire was outside the ordinary course of business or financial affairs of the debtor and the transferee, and the resulting transfer was not made according to ordinary business terms. 11 U.S.C. § 547(c)(2)(B), (C).

Op. at 32-35.

Bank One argues that because its actions with regard to the AMC transfer were not in violation of the SLOC Agreement, they were in the ordinary course of business.

"Congress enacted § 547(c)(2) 'to leave undisturbed normal financial relations, because it does not detract from the general policy of the preference section to discourage unusual action by either the debtor or creditors during the debtor's slide into bankruptcy.' " *In re Energy*

Coop., Inc., 832 F.2d 997, 1004 (7th Cir. 1987) (quoting 1978 U.S.C.C.A.N. 6329). Thus, "[s]ection 547(c)(2) protects 'recurring, customary credit transactions that are incurred and paid in the ordinary course of business of the debtor and the debtor's transferee.' " *Energy Coop.*, 832 F.2d at 1004 (quoting 4 L. King, Collier on Bankruptcy, ¶ 547.10, at 547-42 (15th ed. 1987)).

As the bankruptcy court indicated, the AMC transfer was out of the ordinary. The fact that it was not contrary to the terms of the SLOC Agreement does not necessarily make the transfer a "recurring, customary credit transaction[ ]." Indeed, contrary to Bank One's insistence, the fact that the transfer was unprecedented in both manner and amount points to an extraordinary transaction. As Bank One itself characterizes the Seventh Circuit's opinion in *In re Tolona Pizza*, 3 F.3d 1029 (7th Cir. 1993), "[t]he Seventh Circuit found that the actual conduct of the parties over an extended period of time was more significant than whether that conduct conformed to some 'industry norm.' " Appellant Br. at 27 (quoting *Tolona Pizza*, 3 F.3d at 1032). Bank One presents nothing to indicate that the AMC transfer conformed to the actual conduct of Bergner and Bank One prior to the preference period. Instead, as the bankruptcy court stated, the undisputed facts show that $31,207,000 was an unusually substantial transfer, and that Bank One had not "frozen" Bergner's account nor cancelled AMC's letter of credit on previous occasions. These facts indicate to this court, as they did to the bankruptcy court, that the AMC transfer was not made in the ordinary course of business or financial affairs of Bergner and Bank One. That is enough to defeat Bank One's defense.

B. Whether Bergner's New Owners Can Pursue This Action

Bank One argues that Bergner lacks standing to assert the avoidance actions. Additionally, Bank One argues that because the avoidance recoveries will not benefit Bergner's estate, the preference claims should be dismissed.

1. Standing

Bank One contends that the language contained the confirmed plan was not sufficiently specific to provide for retention and enforcement of this action.

Under 11 U.S.C. § 1123(b)(3)(B), a plan may provide for "the retention and enforcement" of any "claim or interest" by "the debtor, by the trustee, or by a representative of the estate appointed for such purpose." Bergner's plan contained an express provision titled "Avoidance and Recovery Actions," which exempted from Bergner's general waiver of uncommenced avoidance claims "any such actions that may be pending" on the date of approval of Bergner's disclosure statement. On the following page, the plan retained pending adversary proceedings. Likewise, Bergner's disclosure statement made several references to the continued pursuit of pending actions and made specific reference to the AMC and Liberty preferences. At the time of confirmation, Bergner had pursued this action for over a year.

Bank One relies on *In re Harstad*, 155 B.R. 500 (Bankr. D. Minn. 1993), *aff'd*, 39 F.3d 898 (8th Cir. 1994). In that

case, the plan retained "all causes of action between Debtors and any other party, including but not limited to, any right of Debtors to recover assets pursuant to the provisions of the Bankruptcy Code." *Harstad*, 155 B.R. at 510. The court determined that the plan's provision was not sufficiently unequivocal and specific. *Harstad*, 155 B.R. at 510 ("This is an ambiguous, meaningless, blanket statement of no practical significance which ignores the Code's distinction between 'avoidance' and 'recovery.' "). Accordingly, the court concluded that the debtors did not have standing to bring a postconfirmation preference action. In so doing, the court reasoned that its holding was necessary to provide sufficient notice to creditors:

> [R]etention of preference actions is of great consequence to creditors. Usually, those entities which are the subject of a preference action are still creditors and have a right to vote on the debtor's plan. Creditors, exercising that right, must have the informed opportunity to reasonably understand what their benefits and what their potential liabilities are upon confirmation of that plan. However, when the debtor fails to specifically and unequivocally retain preference actions, creditors are effectively stripped of their right to information and are left to vote and accept a plan without realizing that they are potential targets of a postpetition complaint.
>
> . . . .
>
> The provision [at issue here] does nothing to alert a reasonable creditor of potential liability or recovery arising from postpetition preference actions. A reasonable creditor must understand that preferences are being retained.

Harstad, 155 B.R. at 509-10.

The bankruptcy court rejected Bank One's argument at a hearing held on January 20, 1995:

> Defendant has cited several cases which require specific language in a confirmed plan of reorganization for retention of trustee avoidance powers postpetition under § 1123(b)(3)(B) (e.g. *In re Mako[, Inc.*, 985 F.2d 1052 (10th Cir. 1993)]; *In re Harstad*). The purpose of this requirement is to give creditors sufficient knowledge to accept or reject a proposed plan. The creditors should be able to evaluate the proposed dividend and should also know if they will be a target of postpetition recovery actions. In the present case, the confirmed plan specifically waived the right to prosecute claims under §§ 547, 550 or 553, et al., "other than any such actions that may be pending on such date[.]" referring to the date of confirmation. (Plan at ¶ 13.3). Jurisdiction to hear this claim was retained in the bankruptcy court in paragraph 15.1(b) of the confirmed plan. This adversary proceeding had been pending for more than a year at the time the debtor's plan of reorganization was confirmed. This fact alone satisfies any concerns regarding notice that were expressed by the courts in *Harstad* and *Mako*. This court, therefore, finds the confirmed plan adequately provided for the retention of the right to prosecute this adversary proceeding.

Court Minutes of January 20, 1995 Hearing at 2.

As the bankruptcy court concluded, the facts at hand are distinguishable from those at issue in *Harstad*. Most importantly, notice to Bank One of this action simply is not an issue. As Bergner points out, when Bergner's plan was confirmed, it had been prosecuting this action

against Bank One for over fourteen months. Unlike *Harstad*, this is not a postconfirmation action. I agree with the bankruptcy court that the plan's retention of "any such actions that may be pending" on the date of Bergner's disclosure statement is sufficiently specific and unequivocal to put creditors on notice. *See, e.g., In re Acequia, Inc.*, 34 F.3d 800, 807-08 (9th Cir. 1994).

2. For the Benefit of the Estate

Bank One charges that the bankruptcy court "stretched the meaning of 'for the benefit of the estate,' " Appellant Br. at 29, by determining that recovery of the AMC and Liberty preferences would benefit Bergner's estate.

While agreeing that "the trustee powers are not generally transfer[ ]able, and § 550(a) requires a showing of a cognizable benefit to the bankruptcy estate in order for a preference action to stand," Court Minutes of January 20, 1995 Hearing at 2, the bankruptcy court held that Bergner's estate would benefit from recovery in this action:

> Benefit to the estate is sometimes less apparent than direct cash payments to unsecured creditors. The benefit to the estate analysis is made on a case-by-case basis.
>
> Even the narrowest interpretations of the § 550(a) "benefit to the estate" requirement (e.g. *Harstad*) do not require preference recoveries be directly distributed to prepetition unsecured creditors. In the present case, postpetition investors purchased the claims of certain creditors and then waived recovery of cash on account of

> those claims in return for equity in the reorganized debtor. This is a well recognized means of paying creditors in Chapter 11. The investors also made a substantial cash infusion into the debtor corporation, thus facilitating early cash payments to other creditors. The debtor cashed out prepetition creditors up front and the present equity holders, who stood in the shoes of the former creditors whose claims they purchased, have assumed the risk of litigating this adversary proceeding. Any benefit on account of recovery will be because of the current owners' status as creditors, not strangers to the estate. Furthermore, the court believes § 1123(b)(3) recognizes the difference between the purchaser of a debtor's assets, as was the case in *Morning Treat Coffee*, [77 B.R. 62 (Bankr. M.D. La. 1987),] *S & D Foods*, [110 B.R. 34 (Bankr. D. Colo. 1990)] *Mako* and other cases cited by the defendant) and the reorganized debtor, the latter being an authorized successor to the trustee's avoiding powers. The debtor's plan of reorganization, fully disclosed, approved by creditors and confirmed by the bankruptcy court, did not hide the fact postpetition investors would be the immediate beneficiaries of postpetition recovery actions. The court, therefore, holds plaintiff has shown an adequate benefit to the estate for the purposes of § 550(a). . . .

Court Minutes of January 20, 1995 Hearing at 2-3.

I agree with the bankruptcy court that an indirect benefit to the estate is sufficient to satisfy section 550(a). Recovery by Bergner will benefit the largest creditor group in the form of enhanced stock value. *See In re Trans World Airlines, Inc.*, 163 B.R. 964, 973 (Bankr. D. Del. 1994)

("[T]he unsecured creditors will benefit from the enhanced value of reorganized TWA by reason of being shareholders of the reorganized debtor.").

C. Whether Bank One Voidably Set Off

The bankruptcy court determined that both the AMC and Liberty transactions "are appropriately designated setoffs, i.e., the offset of mutual debts":

> The bank owed Bergner the amount in the account as its depositor, and Bergner owed Bank One for draws that had taken place on the AMC letter of credit and for Liberty's inevitable draw. Each seizure and corresponding book entries constituted a set off of those mutual debts, and Bank One's letter to Bergner of August 23, 1991, so states. The July 19, 1991 events resulting in the AMC payment were essentially the same.
>
> Taken in isolation, the seizure of the accounts, by debit or memo posting, might be considered "transfers" as they resulted in the perfection of the bank's security interest. The security interest had arisen in the Standby Letter of Credit Agreement of July 26, 1989, but the interest was unperfected until seizure occurred. The perfection of a security interest results in a transfer that would require analysis under 11 U.S.C. § 547(b) and consideration of the bank's defenses under 11 U.S.C. § 547(c), as was shown above.
>
> Under the instant facts, the characterization of events as a transfer or a setoff results in a distinction without a difference. Bergner is

> entitled to recover the amount seized under either statute.

Op. at 41-42.

Bank One contends that "[b]ecause, however, the Bankruptcy Court reached its faulty conclusion without analyzing whether the parties had mature debt capable of setoff – which they did not – or whether Bank One had both the intent and documentation of exercising a right to setoff, this Court should reverse its holding." Appellant Br. at 36. Bank One argues that 11 U.S.C. § 553(b) is inapplicable because under Wisconsin law, the parties' debts were not capable of setoff, and because there was no evidence of Bank One's intent to setoff or documentation showing a setoff had occurred.

Section 553(b) allows the debtor to recover amounts set off by a creditor against amounts owed the creditor by the debtor, to the extent the setoff improved the creditor's position. The occurrence of a setoff is shown by a decision to effectuate a setoff, an action to accomplish it, and a recording of the setoff. *Citizens Bank v. Strumpf*, ___ U.S. ___, ___, 116 S. Ct. 286, 289 (1995).

Under the SLOC Agreement, the fact of AMC's draw made the $31,207,000 immediately payable to Bank One by Bergner. Likewise, Bergner's imminent bankruptcy created an event of default on August 23, 1991, and thus, under the SLOC Agreement, Bergner owed Bank One for all amounts that could be drawn on the Liberty letter of credit, making to $6,358,000 immediately due and payable to Bank One by Bergner. A debt which is payable immediately or upon demand is a mature debt capable of

setoff. *See Federal Deposit Ins. Corp. v. First Mortgage Investors*, 485 F. Supp. 445, 455 (E.D. Wis. 1980). Thus, Bergner's obligations to Bank One were mature and capable of setoff at the times in question.

The undisputed facts also satisfy each of the setoff elements. Bank One had the intent to permanently settle accounts with Bergner by canceling its debt to Bergner (i.e., Bergner's deposits in its Bank One account) against Bergner's debt to it under the SLOC Agreement. Indeed, with regard to the Liberty transaction, Bank One notified Bergner that "on August 23, 1991, the Bank set off funds in your account." By debiting Bergner's account on both occasions and crediting its own Standby Letter of Credit General Ledger Account on July 19, 1991 and Cash Letter of Credit Account on August 23, 1991, Bank One acted to permanently reduce Bergner's account balance by the amount of Bergner's obligations under the SLOC Agreement. Accordingly, the bankruptcy court was correct in finding that both the AMC and Liberty transactions were setoffs.

D. Single Satisfaction

Bank One's final argument is that the bankruptcy court's decision resulted in a proscribed double recovery. Under 11 U.S.C. § 550(d), "[t]he trustee is entitled to only a single satisfaction under subsection (a) of this section," which provides for recovery of avoidable transfers. Bank One contends that Bergner received its "single satisfaction" in the form of goods from AMC and insurance from Liberty.

The Bankruptcy court rejected this argument, reasoning that section 550 prevents recovery by a debtor from multiple transferees:

> Section 550(d) allows only a single recovery under subsection (a), which designates transferees from whom recovery may be sought. Bank One is the initial transferee of the funds taken from Bergner, and AMC and Liberty are transferees of the initial transferee. 11 U.S.C. § 550(a). Subsection (b) of § 550 provides that a subsequent transferee who acquires a transfer for value, including satisfaction of an antecedent debt, is not subject to recovery. As Bank One had independent antecedent debts to AMC and Liberty by virtue of its letters of credit, which were satisfied by the bank's payments, Bergner cannot recover from those entities. 11 U.S.C. § 550(b)(1).
>
> Bergner cannot pursue AMC and Liberty as creditors who received indirect transfers or for whose benefit transfers were made. 11 U.S.C. § 547(b)(1). AMC and Liberty were not Bergner's creditors when payment was made. They were only Bank One's creditors.
>
> Had Bank One not seized the account on those two occasions, Bergner would have had precisely what it now seeks, the funds in its account. Bank One's independent obligations would have eventually inured to Bergner's benefit because of Bank One's payments, but as the bank points out, Bergner had no enforceable right to those benefits by virtue of having its bank account seized. Any benefit to Bergner arose as a result of Bank One satisfying its own liabilities, not on account of the transfer from Bergner.

> In sum, Bergner has only one preference defendant, actual or potential, and only one recovery. *In re Skywalker, Inc.*, 155 B.R. 526, 530 (9th Cir. BAP 199[3]). This satisfies the requirement of a single recovery as provided by 11 U.S.C. § 550(d).

Op. at 43-44.

In re Skywalker, Inc., 155 B.R. 526 (Bankr. 9th Cir. 1993), *aff'd*, 49 F.3d 546 (9th Cir. 1995), is directly on point. In that case, the creditor-appellant argued that the trustee received two recoveries, in the form of a liquor license and the proceeds from its sale. Noting that section 550 "addresses from whom a monetary recovery may be made," the court held:

> The fact that the estate retained the license and received the proceeds of its sale is of no consequence to the preference action. [Creditor-appellant] Loo still retains an unsecured claim for the amount owed her on the unpaid contract of sale; the Skywalker estate still owes Loo. What she will receive from the estate will be determined pursuant to the distribution provisions of the Code, as will payment of other unsecured claims. She will not, however, be able to retain preferential payments in satisfaction of her claim. Section 550 simply prevents the trustee from obtaining the same recovery twice, for example once from Loo and a second time from [guarantors] Walker and Alguire.

Skywalker, 155 B.R. at 530.

Such is the case here. It is of no matter that Bergner received credit at AMC and insurance from Liberty; it

seeks one recovery from one creditor – Bank One. Section 550(d) does not prevent that recovery.

E. Prejudgment Interest

Bergner, as cross-appellant, argues that the bankruptcy court erred in denying it prejudgment interest. The bankruptcy court denied prejudgment interest to Bergner on the basis that it would be a "windfall":

> Interest is to compensate the debtor for its inability to use the funds while in the transferee's control, but it is unlikely that Bergner would have had use of the money subsequent to the transfer. Unsecured creditors received $.33 on the dollar under the debtor's plan. Had the debtor had sufficient cash, chances are that number would have been higher. As debtor would have had to fund the plan, it is doubtful that Bergner would have retained the funds. Consequently, at this point, prejudgment interest would be a windfall to Bergner.

Op. at 44-45.

Citing several nonbankruptcy cases, Bergner argues that award of prejudgment interest to federal plaintiffs is near automatic. *See Pratigton v. Broyhill Furniture Indus., Inc.*, 999 F.2d 269 (7th Cir. 1993); *In re Oil Spill by Amoco Cadiz*, 954 F.2d 1279 (7th Cir. 1992). Missing from Bergner's argument is analysis in the bankruptcy context, which, as the bankruptcy court pointed out, may have differing considerations from other federal cases.

Whether to grant prejudgment interest in a preference action is within the bankruptcy court's discretion.

E.G., In re Cybermech, Inc., 13 F.3d 818, 822 (4th Cir. 1994); *In re Energy Coop., Inc.*, 130 B.R. 781, 792 (N.D. Ill. 1991). Bergner points out that the court in *Energy Coop.* awarded prejudgment interest (as did the court in *Cybermech*), but the question is not whether bankruptcy courts frequently award prejudgment interest. Instead, it is whether the bankruptcy court in this case abused its discretion in denying prejudgment interest. As the bankruptcy court noted, the purpose of prejudgment interest is to compensate the debtor's estate for the creditor's use of those funds that were wrongfully withheld from the debtor's estate while the preference action was pending. *In re Investment Bankers, Inc.*, 4 F.3d 1556, 1566 (10th Cir. 1993), *cert. denied, Davis, Gillenwater & Lynch v. Turner*, 510 U.S. 1114 (1994). The bankruptcy court determined that it was doubtful that Bergner would have benefitted from interest on the funds in question, had the preferential transfers not been made by Bank One. *Cf. Cybermech*, 13 F.3d at 822. Although I might have found differently, I do not believe the bankruptcy court abused its discretion in so finding. Thus, I will affirm the bankruptcy court's denial of prejudgment interest to Bergner.

III. CONCLUSION

For the reasons stated above, I will affirm the bankruptcy court's decision granting summary judgment to Bergner in all respects.

Accordingly,

IT IS ORDERED that the appeal from the bankruptcy court's decision dated July 28, 1995, filed by Bank One, be and the same is hereby **DENIED**;

IT IS FURTHER ORDERED that the cross-appeal from the bankruptcy court's decision dated July 28, 1995, filed by Bergner, be and the same is hereby **DENIED**; and

IT IS FURTHER ORDERED that the bankruptcy court's decision dated July 28, 1995, be and the same is hereby **AFFIRMED** in all respects.

Dated at Milwaukee, Wisconsin, this 10th day of October, 1996.

BY THE COURT:

/S/ J. P. Stadtmueller
J. P. Stadtmueller
Chief Judge

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In re P.A. BERGNER & CO. HOLDING CO., et al., Debtors.

P.A. BERGNER, Plaintiff,

v.

BANK ONE, MILWAUKEE, N.A., Defendant.

Bankruptcy Nos. 91-25501 to 91-25516 and 93-20736.
Adv. No. 93-2323.

July 28, 1995.

AMENDED MEMORANDUM DECISION

M. DEE McGARITY, Bankruptcy Judge.

Introduction

This adversary proceeding for recovery of an avoidable preference or setoff was brought by the debtor in possession, P.A. Bergner & Co. Holding Company ("Bergner" or "debtor") against its prepetition creditor, Bank One, Milwaukee, N.A. ("bank," "creditor" or "Bank One"), on April 26, 1992. For ease of reference, the plaintiff will be referred to as "Bergner" or the "debtor," notwithstanding that the time frame being discussed might be before filing, during the pendency of the Bergner cases, or after confirmation.

The debtor, now known as Carson Pirie Scott & Co., and 14 related entities filed voluntary petitions under chapter 11 on August 23, 1991. Another related entity filed its petition on December 2, 1992. A joint plan of

reorganization for all cases, with one exception not pertinent here, was confirmed on October 15, 1993. Shortly after confirmation, final payments under the plan were completed. Bergner's general unsecured creditors received $.33 per dollar of claim, and the class of creditors that purchased the debt owed to a group of lenders headed by Swiss Bank (which appears to have been partially secured and partially unsecured) received equity in the reorganized entity. The plan further provided that the debtor retained the right to prosecute any pending preference actions in its own behalf, and this court has previously held that the provision in the plan was sufficiently explicit to give the postconfirmation entity standing to continue the action (see minutes of hearing on January 20, 1995). At the same January 20, 1995 hearing, the court dismissed two counts in the plaintiff's First Amended Complaint that referred to 11 U.S.C. § 553(a) as inapplicable to the facts of this case. Also, Bergner withdrew its claims respecting any letters of credit issued by defendant, other than those benefitting Bergner's supplier, Associated Merchandising Corporation ("AMC"), and Bergner's insurance carrier, Liberty Mutual Insurance Company ("Liberty").

Both parties have moved for summary judgment on the issue of whether the debtor can recover as an avoidable preference under 11 U.S.C. § 547, or as an avoidable setoff under 11 U.S.C. § 553(b), payments made by Bergner to Bank One for draws on letters of credit issued to AMC and Liberty. For the reasons stated herein, Bergner's motion for summary judgment is granted, and Bergner is entitled to recover both payments as a matter of law.

This court has jurisdiction over this proceeding pursuant to 28 U.S.C. § 1334(b); this is a core proceeding under 28 U.S.C. § 157(b)(2)(F). This memorandum decision constitutes the court's findings of fact and conclusions of law in accordance with Fed.R.Bankr.P. 7052.

Facts

The events that transpired between the parties are not in dispute. These facts are derived from briefs, affidavits and exhibits filed with the court, and no facts appear to be controverted.

The plaintiff in this action was, and continues to be after confirmation, the holding company for a number of large department stores, primarily in the Midwest. The defendant is the bank in which Bergner's primary operating account was located. The bank also issued letters of credit in substantial amounts to entities with whom Bergner did business, such as the inventory supplier and insurance company that were the beneficiaries of the letters of credit referenced in this action.

On July 26, 1989, Bank One and Bergner entered into a Standby Letter of Credit Agreement, the master agreement under which the bank would issue standby letters of credit to be paid only if Bergner failed to pay directly amounts owed the beneficiaries or if any other event of default occurred. The pertinent events giving rise to payment pursuant to the two letters of credit at issue in this case were (1) the failure of Bergner to pay amounts due the beneficiaries, (2) the nonrenewal of the letter of credit, and (3) the presentation of conforming documents by the beneficiary. The master agreement required that

Bergner pay Bank One amounts drawn on a letter of credit before such amounts were paid by the bank, but payment did not affect the bank's obligation to the beneficiary. *See, generally, Matter of Compton Corp.*, 831 F.2d 586, 589-91 (5th Cir.1987); *Toyota Indus. Trucks U.S.A., Inc. v. Citizens Nat'l Bank of Evans City*, 611 F.2d 465, 469-71 (3rd Cir.1979); *Matter of Val Decker Packing Co.*, 61 B.R. 831, 837-39 (Bankr.S.D.Ohio 1986).

The master agreement was automatically renewable unless the bank determined not to do so, a so-called "evergreen" type of agreement. If Bank One elected not to renew, it was required to give Bergner and the beneficiaries 60 days notice of its decision. The agreement granted the bank a security interest in funds on deposit with Bank One, but it contained no other collateral for a debt that might arise in connection with a draw.

Standard letters issued to AMC and Liberty provided that if Bergner failed to pay outstanding amounts due the entities, Bank One was obligated to the entities up to the amount of the letter of credit. The amounts outstanding on these letters of credit fluctuated over the years, depending on obligations that Bergner had outstanding to the beneficiaries of the letters of credit or, in the case of AMC, the amount of its outstanding orders for merchandise. Bergner paid a fee as consideration for issuing the letters, which various figures put in the neighborhood of $300,000.

Associated Merchandising Corporation

Associated Merchandising Corporation (AMC), a cooperative buying association acting on behalf of a

consortium of department stores, is the purchaser of goods manufactured primarily in Pacific Rim countries. Goods are ordered by the retailers, and AMC contracts with its suppliers for their manufacture. AMC makes its own financial arrangements with manufacturers. It then resells these goods to retailers, such as Bergner, throughout the world. Goods are invoiced to AMC's buyers as soon as they are shipped, and payment is due within 48 hours.

In 1989, AMC required a standby letter of credit to cover the possibility of its not being paid for goods on order to Bergner. Such a letter was provided by Bank One, and there were nine amendments to the original letter as orders fluctuated. When AMC finally drew on the letter, the amount outstanding was $31,207,000. Ninety days before filing, the amount was over $37,000,000. Until the transfer sought to be avoided was made, Bank One had never paid on a standby letter of credit issued to AMC.

On May 23, 1991, Bank One sent a letter to Bergner stating that Bank One would not be renewing its letter of credit. It also notified AMC, and both Bergner and Bank One knew that AMC would now be entitled to draw on the letter of credit, notwithstanding the fact that Bergner owed nothing to AMC at the time. Anticipating a draw on its obligation to AMC, Bank One demanded that Bergner deposit $31,000,000 in its account at Bank One.

On July 19, 1991, AMC presented conforming documents to draw on the letter of credit, nonconforming documents having been presented two days earlier. At the time conforming documents were presented, Bergner

had at least $207,000 in its Bank One account. At 11:02 a.m., Bank One received a deposit of $31,000,000 to Bergner's account, which Bergner had acquired by drawing on its revolving line of credit with the Swiss Bank lenders. At 11:15 a.m., Bank One notified Bergner that it had received the funds. At 1:24 p.m., Bank One "memo posted" Bergner's account for the $31,207,000 to be sent to AMC, which means that it effectively froze the account, and prevented Bergner from using the funds for any purpose other than to fund the AMC wire. At 2:11 p.m., Bank One wire transferred $31,207,000 to AMC's account at Hong Kong Shanghai Bank via Bank One's account at the Federal Reserve, thus giving Bergner a credit balance at AMC for goods not yet shipped. At the end of the day, Bank One debited Bergner's account for the amount transferred to AMC. Bank One's internal "Standby Letter of Credit General Ledger Account" was credited for the payment. This account records outstanding standby letters of credit for which the bank might be held liable in the future. Except for the deposit from Swiss Bank, all of the pertinent activity in Bergner's account on July 19, 1991, was initiated by Bank One, not by Bergner.

Thirty-five days later, on August 23, 1991, the Bergner chapter 11 cases relevant to this proceeding were filed. Bergner owed Bank One nothing on its AMC letter of credit obligation. AMC continued to ship goods to Bergner, and most of the credit balance was consumed by postpetition shipments.

Bergner now seeks to recover the prepetition transfer of $31,207,000 to Bank One.

Liberty Mutual Insurance Co.

Liberty was the holder of a letter of credit under the same master agreement as AMC, which covered charges for past insurance coverage. On May 24, 1991, Bank One notified Liberty it would not renew its letter of credit for Bergner when the letter expired on July 31, 1991. Non-renewal was an event of default under the agreement, and Liberty was at that time entitled to draw approximately $5,800,000. However, on July 29, 1991, two days before the existing letter of credit expired, Bank One agreed to issue a new letter of credit for $6,358,000, thus allowing Bergner to continue insurance coverage and avoiding an immediate draw by Liberty. The new letter of credit provided it could be drawn on only after July 31, 1991, the expiration date of the old letter. Therefore, Bank One's obligation to Liberty and Bergner's letter of credit coverage were uninterrupted.

Two days after the new letter of credit was issued, Bank One learned of the deterioration of Bergner's relationship with Swiss Bank. By letter dated July 31, 1991, Bank One demanded that Bergner keep sufficient funds in its account, at least $6,400,000, to cover the amount outstanding on the Liberty letter of credit. Bergner agreed to maintain the required balance, but in fact, on August 2, 1991, the account was overdrawn. Bergner maintained a balance in excess of $6,400,000 after August 2, 1991, until its bankruptcy filing. Except for the requirement of a minimum balance, the bank did not restrict the account, nor did it ever dishonor checks.

On August 23, 1991, Bergner informed Bank One it intended to file its bankruptcy petition. Bank One immediately debited the account by $6,358,000, and wrote a letter to Bergner stating it had set off the account in the amount of the Liberty letter of credit. The money was deposited in the bank's "Cash Letter of Credit Account," an account kept on Bank One's books for its outstanding letters of credit, and commingled with other bank funds in the account. When the petitions were filed later that morning, no debt was owed Bank One on account of the Liberty letter of credit. The Cash Letter of Credit Account was debited from time to time as Liberty drew on the letter postpetition.

Bergner also seeks to recover the $6,358,000 transferred from the Bergner account to Bank One on August 23, 1991.

Summary Judgment Standard

The policy of the summary judgment procedure is to dispose of factually unsupported claims or defenses, to serve judicial economy, and to avoid unnecessary litigation. *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986); *Cloutier v. United States*, 19 Cl.Ct. 326 (1990).

Motions for summary judgment in bankruptcy are governed under Fed.R.Bankr.P. 7056, which specifically references Fed.R.Civ.P. 56. A motion for summary judgment:

> shall be rendered forthwith if the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits,

> if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law.

Fed.R.Civ.P. 56(c).

In ruling on a motion for summary judgment, the court shall view the facts in a light most favorable to the party opposing the motion. *Brock v. American Postal Workers Union*, 815 F.2d 466, 469 (7th Cir.1987). The court's role is not to weigh the evidence on the merits but to determine whether there is a genuine triable issue in dispute. *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 249, 106 S.Ct. 2505, 2510, 91 L.Ed.2d 202 (1986). When there are numerous issues in dispute, summary judgment may be used to reduce the number of issues that must be tried and focus the parties on only those issues involving factual disputes.

A party who moves for summary judgment has the initial burden of showing either the absence of a genuine issue of material fact or a complete lack of evidence to support a necessary element of other party's case or defense. *Celotex*, 477 U.S. at 323, 106 S.Ct. at 2552-53. If this burden is met, the nonmoving party then has the burden of showing the existence of a genuine factual dispute regarding an essential element of its case or defense. *Id.* at 322-25, 106 S.Ct. at 2552-54. In order to rebut movant's case for summary judgment, the nonmoving party will generally have to go beyond the pleadings and present evidence, by affidavit, deposition or otherwise, to "set forth specific facts showing that there is a genuine issue for trial." Fed.R.Civ.P. 56(e); *Celotex*, 477 U.S. at 324, 106 S.Ct. at 2553. "If the adverse party does

not so respond, summary judgment, if appropriate, shall be entered against the adverse party." *Id.*

Both parties have filed cross motions for summary judgment on the merits of the case.

For the first time at oral argument on this motion, counsel for Bank One raised the issue of whether Bergner's motion for summary judgment permitted a final determination on the bank's defenses. Counsel argued that this court could determine whether all of the elements of 11 U.S.C. § 547(b) were met, but the bank's defenses under 11 U.S.C. § 547(c) could not be determined in Bergner's favor because of the wording of Bergner's motion. There was no argument that the bank did not have sufficient notice that Bergner was asking for a decision on the merits disposing of the entire case.

Bergner asked for summary judgment in its favor on counts Three, Four, Seven, Eight and Nine of its First Amended Complaint. These counts seek recovery under 11 U.S.C. § 550 for avoided transfers pursuant to 11 U.S.C. §§ 547 and 553(b). Subsection (b) of § 547 states that the trustee can avoid a transfer of the debtor's interest in property "[e]xcept as provided in subsection (c) of this section[.]" A recovery under 11 U.S.C. § 547(b) necessarily includes a determination of the creditor's defenses under 11 U.S.C. § 547(c), and the provisions of the latter subsection are effectively incorporated by reference in the former. Both are appropriate for summary judgment under these facts.

This court is satisfied that Bergner's motion is adequate to allow this court to find in its favor without the necessity for a trial on the bank's defenses. As Bergner is

entitled to recover the full amount of the transfers, whether characterized as preferences or setoffs, the distinction is unnecessary.

Preference Elements – 11 U.S.C. § 547(b)[1]

Introduction – Transfer of debtor's interest in property.

The plaintiff has the burden of proof to show by a preponderance of the evidence that each of the five elements of an avoidable preference exist. 11 U.S.C. § 547(g).

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[1] (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –

(1) to or for the benefit of a creditor;

(2) for or on account of an antecedent debt owed by the debtor before such transfer was made;

(3) made while the debtor was insolvent;

(4) made –

(A) on or within 90 days before the date of the filing of the petition; or

(B) between ninety days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and

(5) that enables such creditor to receive more than such creditor would receive if –

(A) the case were a case under chapter 7 of this title;

(B) the transfer had not been made; and

(C) such creditor received payment of such debt to the extent provided by the provisions of this title.

11 U.S.C. § 547(b).

The initial requirement for an avoidable preference appears in the introductory section of 11 U.S.C. § 547(b), before the enumeration of the five preference elements. This is the starting point in the analysis of whether a preference has occurred.

Bank One argues that no interest of the debtor in property was transferred by the debit for either letter of credit because a corresponding asset was acquired by the debtor, namely a credit balance with AMC and a credit with Bank One for payment of insurance charges by Liberty. Under this theory, the bank was merely a conduit for the movement of funds. Thus, the debtor's assets were not diminished by the transfers. If the debtor's assets were not diminished by the transfers, the argument continues, there could not have been a transfer of the debtor's interest in property to be avoided.

A number of cases interpret this introductory paragraph of 11 U.S.C. § 547(b) as a requirement that the debtor's estate be diminished by the transfer sought to be avoided. This is akin to a sixth requirement under 11 U.S.C. § 547(b), although this requirement actually comes first.

Bank One argues that this sixth element was not met as there was no transfer because the debtor had credits in place of its cash. Even if there were a transfer, Bank One argues, there was no diminution in the value of Bergner's property; hence, no preference. However, the concept of "diminution of the estate" (technically, diminution of the debtor's property before the estate arises) is a holdover of the preference recovery provision under the Bankruptcy Act. While the requirement does not explicitly appear in

11 U.S.C. § 547(b), the concept has been left undisturbed in the Seventh Circuit without the necessity for analysis. *See Matter of Smith*, 966 F.2d 1527, 1535-7 (7th Cir.1992), *cert. dismissed* ___ U.S. ___, 113 S.Ct. 683, 121 L.Ed.2d 604 (1992).

Whether "transfer" and "diminution" are two different concepts, or whether "diminution" is merely descriptive in determining whether a transfer of the debtor's interest in property transpired, this court holds that the debtor's property was transferred with the memo posting and debits Bank One made to cover payment of the AMC and Liberty letters of credit. Furthermore, the debtor's property was diminished by each transfer.

The primary means for determining whether property was transferred is to examine who had control over the property at a particular time and whether that control shifted from one party to another. In an unrestricted bank account, the depositor has control over the funds because it can withdraw the funds at will. *Matter of Prescott*, 805 F.2d 719, 729 (7th Cir.1986). If control shifts, a transfer has occurred.

While unrestricted funds were property of the debtor, the subsequent restriction of those funds resulted in a transfer to the bank. *Bonded Fin. Serv., Inc. v. European Am. Bank*, 838 F.2d 890, 893 (7th Cir.1988). A "transfer" is defined in 11 U.S.C. § 101(54) as "every mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with property or with an interest in property . . . " *Bonded Fin. Serv.* describes a transfer as occurring when the transferee obtains "dominion" over the property and the right to put the property

to its own purposes. *Id.* Applied to the facts of this case, before the memo posting occurred, Bergner had control of the funds in its account. Earlier, Bergner had control over the $31,000,000 it had borrowed from Swiss Bank; Bergner demonstrated this control by telling Swiss Bank where to send the funds. For over two hours, from the time the money was deposited until Bank One memo posted the account, the funds were unrestricted. The memo posting froze the account and transferred control, and the debiting of the account completed the seizure, thereby changing ownership as well as control. Therefore, a prepetition transfer of Bergner's funds occurred when Bank One memo posted and took control over the $31,207,000.

To refute this proposition, the bank maintains it was only sending Bergner's funds to AMC. Its control demonstrates this was not so. Bergner did not instruct Bank One to send its funds to AMC; no check, debit memo or similar direction from Bergner has been disclosed and offered as evidence. Bank One made the decision when to pay AMC. The funds wired to AMC were the bank's funds. *Matter of Compton Corp.*, 831 F.2d 586, 589 (5th Cir.1987), *reh'g granted*, 835 F.2d 584 (5th Cir.1988). These funds had already been transferred from Bergner to the bank when the account was seized prior to the AMC wire.

The concept becomes clearer when the bank is correctly viewed not as a receptacle of funds but as a debtor to its depositors and the owner of all of its funds. *See, e.g., In re CJL Co., Inc.*, 71 B.R. 261, 265 (Bankr.D.Or.1987); *In re Zimmerman*, 69 B.R. 436, 438 (Bankr.E.D.Wis.1987). The $31,207,000 was transferred by seizure of the funds wired

to the debtor, and the bank later transferred its own funds to AMC.

The fact that $31,000,000 of the funds seized by Bank One for the AMC wire were borrowed from Swiss Bank is of no consequence. The transfer of borrowed, unrestricted funds results in the diminution of the debtor's property within the meaning of 11 U.S.C. § 547(b). *Smith*, 966 F.2d at 1533. In *Smith*, the bank had allowed the debtor to write checks on a deposit that was subsequently dishonored. This made the bank an inadvertent and involuntary lender. Nevertheless, the court held that payment to a creditor with a check written on these "borrowed" funds resulted in an avoidable preference to the creditor, and the preference had to be returned to the trustee.

If diminution in the debtor's property were a separate requirement for preference recovery, and this court is by no means certain that it is, the transfers from Bergner's account meet this requirement. To determine whether the transfer diminished the debtor's property, it is useful to examine what property the debtor would have had at the time of filing absent the transfer. Here, the debtor would have had the cash in its accounts, including $37,565,000 for the two debits. It would also have had whatever accrued to it by virtue of Bank One honoring the letters of credit, for which Bergner had paid substantial consideration. Bank One intimates that it might not have paid its obligations on the letters, a remarkable posture for a reputable bank to take. Nevertheless, the bank is correct that Bergner is not a third party beneficiary of the letters, and Bergner could not compel compliance on the beneficiaries' behalf. This merely underscores the independence of Bank One's

obligation to AMC and Liberty and Bergner's obligation to Bank One. *See In re Security Services, Inc.*, 132 B.R. 411, 414-15 (Bankr.W.D.Mo.1991); *Matter of Val Decker Packing Co.*, 61 B.R. at 837-39. However, even if Bank One had successfully evaded its obligations under the letters of credit, the substantive difference between having unrestricted cash of $37,565,000 and having credits of $37,565,000 that can be used only for one supplier, AMC, and for one insurance carrier, Liberty, is significant enough to constitute diminution of the debtor's property.

The "earmarking doctrine," developed to interpret whether an interest of the debtor in property has been transferred, clearly does not apply to these facts. Earmarking occurs only when a new creditor advances funds, and the parties intend that those funds be used to pay an antecedent creditor. Payment of the old creditor is a condition for obtaining the new credit. *See, e.g., Matter of Smith*, 966 F.2d at 1533; *In re Love*, 155 B.R. 225, 230 (Bankr.D.Mont.1993). This type of transfer results only in the substitution of creditors, and there is no diminution in the debtor's property. Swiss Bank loaned the funds with no agreement as to their use to pay AMC; in fact, Swiss Bank's representative testified at his deposition that Swiss Bank had no right under the loan agreement to direct how Bergner used its borrowed funds. Therefore, the earmarking doctrine does not apply.

Similarly, Bank One's debit to the debtor's account to pay its liability on the Liberty letter of credit constituted a transfer of the debtor's funds to a special account in the bank's control, the "Cash Letter of Credit Account." These were commingled with other Bank One funds in the account. The debtor could neither control nor direct

how those funds were to be used because they were no longer the debtor's funds. This satisfies the initial requirement that there be a transfer of the debtor's interest in property.

The following is a discussion of the five elements of 11 U.S.C. § 547(b), as they relate to the $31,207,000 debit of Bergner's account for the AMC letter of credit and the $6,358,000 debit for the Liberty letter of credit. The court is satisfied that Bergner has met its burden of proof as to all of these elements as a matter of law.

AMC

1. *To or for the benefit of a creditor.*

The bank argues that the $31,207,000 transferred was from Bergner to AMC, which was neither a creditor at the time of the transfer nor a defendant in an adversary proceeding, not from Bergner to the bank. It maintains the bank merely served as a conduit or vehicle for the transfer of Bergner's funds. Alternatively, the bank argues that when it did receive the funds, the bank was not Bergner's creditor because it had not yet paid AMC. Following this reasoning, if Bank One were not a creditor, it could not have received a preference.

Neither of Bank One's characterizations of the AMC account debit is persuasive. As was discussed in the introductory section, the memo posting of Bergner's account was a transfer to Bank One. Bank One then posted the funds to its own Federal Reserve account, which it argues is a prerequisite for a wire transfer on behalf of a depositor. This may indeed be so. However, the mechanics of wire transfers notwithstanding, the

bank had control over where the money went. It went to AMC at Bank One's direction, not Bergner's. Thus, the bank transferred its own funds. *See also Matter of Val Decker Packing Co.*, 61 B.R. at 839. Furthermore, the transfer was for Bank One's benefit in that it eliminated the bank's liability to AMC on account of its letter of credit. When the debtor pays an obligation of another party, it has made a transfer for the benefit of that party, which can be avoided as a preference. *See, e.g., Levit v. Ingersoll Rand Fin. Corp.*, 874 F.2d 1186, 1192 (7th Cir.1989) (transfer to creditor by principal was preference to guarantor).

The bank claims it was not a creditor of Bergner at the time of the debit. It cites various commentators and cases that describe a liability to the issuing bank as arising when the letter of credit is paid, not before. However, the Standby Letter of Credit Agreement in this case states otherwise. The bank was at least a contingent creditor before it paid AMC, which satisfies the definition of "creditor" under the Bankruptcy Code. 11 U.S.C. § 101(10); *see also* 11 U.S.C. §§ 101(5), (12); *Matter of Milwaukee Cheese*, 164 B.R. 297, 305 (Bankr.E.D.Wis.1993). More accurately, because AMC had presented conforming documents for the draw earlier the same day, and because Bergner was contractually obligated to pay *Bank One* (not AMC) before payment of the draw, the obligation had matured and was no longer contingent. Payment to AMC, with its attendant liability of Bergner to Bank One, was a certainty after presentation of conforming documents. Bank One demanded the deposit, as it had a right to do under the contract. The bank's distinction that payment was *due*, even though the liability had not yet been *incurred*, is unavailing. That distinction has already been

rejected elsewhere. *In re Western World Funding, Inc.*, 54 B.R. 470, 476-77 (Bankr.D.Nev.1985). If an entity is entitled to payment, how can that entity not be a creditor under the Bankruptcy Code's expansive definition? Obviously, an entity entitled to payment is a creditor. 11 U.S.C. § 101(10).

Finally, the only reason Bergner would create a huge credit with AMC is to satisfy its obligation to Bank One. After all, Bergner owed AMC nothing. Therefore, the court finds that Bank One was a creditor of Bergner, and the seizure of Bergner's funds from its account by memo posting, followed by debit and transfer to Bank One accounts, satisfies the requirement under 11 U.S.C. § 547(b)(1) of a transfer to a creditor or for the benefit of a creditor.

2. *For or on account of an antecedent debt owed by the debtor, before such transfer was made.*

Bank One characterizes this transaction as a transfer from Bergner to AMC. Bergner was not obligated to prepay AMC, and the bank is correct that prepayments, at least those not required by contract, are not antecedent debts. But Bergner is not asking to recover the funds paid to AMC; it seeks to recover the funds seized from its account by Bank One. Bank One is the creditor referred to in 11 U.S.C. § 547(b)(2), not AMC. Here, Bank One had an independent obligation to AMC under the standby letter of credit, which is separate from Bergner's obligation to Bank One. *See Matter of Compton Corp.*, 831 F.2d at 590; *In re Carley Capital Group*, 119 B.R. 646, 647-48 (W.D.Wis.1990); *In re Security Services, Inc.*, 132 B.R. 411,

414 (Bankr.W.D.Mo.1991). *See also Toyota Indus. Trucks U.S.A., Inc. v. Citizens Nat'l. Bank of Evans City,* 611 F.2d at 469-70. The bank was obliged to perform whether Bergner prepaid the bank or not.

Bank One argues it was only a contingent creditor of Bergner, and a contingent creditor cannot hold an antecedent debt within the meaning of 11 U.S.C. § 547(b)(2). On the contrary, contingent debts are also antecedent debts within the meaning of 11 U.S.C. § 547(b)(2). *See, e.g., Matter of Milwaukee Cheese,* 164 B.R. at 305; *Matter of Val Decker Packing Co.,* 61 B.R. at 841. Cases cited by the bank, such as *Matter of Wey,* 854 F.2d 196 (7th Cir.1988), are distinguishable. In *Wey,* the transfer sought to be avoided was the forfeiture of a down payment that occurred when the debtor could not complete a sale. The court stated that a debt does not arise until there is a legal obligation to pay, and the debtor was not obligated to pay until closing. There was no debt until his breach, which extinguished his interest in the down payment previously transferred. The breach resulted in no transfer as well as no antecedent debt. This is distinguishable from cases such as *Milwaukee Cheese,* in which the liability for payment was certain, but the timing of payment or the happening of an additional event was uncertain.

In this case, events had developed to a point of certainty that made Bank One no longer a contingent creditor. The letter was not to be renewed, which was an event of default. Moreover, AMC had drawn on its letter. This meant that when Bergner's account was seized, Bergner's debt to Bank One had matured and was payable. The agreement between Bergner and Bank One required payment before the draw, not reimbursement

after the draw; thus, the money was already owed to Bank One when the debit of Bergner's account occurred. The obligation sought to be avoided was not a prepayment to AMC; it was payment on a mature obligation of Bergner to Bank One. This satisfies the requirement that the transfer was on account of an antecedent debt owed by the debtor before the transfer was made. 11 U.S.C. § 547(b)(2).

3. *Made while the debtor was insolvent.*

This is not disputed by the parties. The debtor was insolvent at all times during the 90 days before filing.

4. *Made within 90 days before the date of filing the petition.*

It is undisputed that the transfer in question was made 35 days before filing of the petitions under chapter 11.

5. *That enables the creditor to receive more than it would in a chapter 7 case if the transfer had not been made.*

Bergner asserts, without refutation by Bank One, that unsecured creditors would have received nothing if the transfer had not been made and if Bergner and its companion cases had been filed under chapter 7. Bank One was paid in full. Therefore, if the transfer of $31,207,000 to Bank One is avoidable, it is avoidable in full.

Nevertheless, Bank One argues that it had a security interest in Bergner's account, and it would have been

paid 100 cents on the dollar in a chapter 7 case, not 0 cents on the dollar as an unsecured creditor. To the extent a creditor is paid on an unavoidable secured claim during the preference period, the payment is not subject to recovery as a preference. *See, e.g., Levit v. Ingersoll Rand,* 874 F.2d at 1199-1200; *Barash v. Public Fin. Corp., et al.,* 658 F.2d 504, 508 (7th Cir.1981). Thus, a transfer within the preference period can pay the secured creditor 100% of the claim and not run afoul of 11 U.S.C. § 547(b)(5). The fact that unsecured creditors actually received $.33 on the dollar of claim is irrelevant to this test.

The master Standby Letter of Credit Agreement granted Bank One a security interest in accounts at Bank One. However, an unperfected security interest is subject to avoidance. *See, e.g.,* 11 U.S.C. § 544(a). Furthermore, a previously unperfected security interest that is perfected during the preference period is also subject to avoidance. 11 U.S.C. § 547(b). As deposit accounts are not governed by the Uniform Commercial Code, Wis.Stat. § 409.104(13), perfection must be accomplished under the common law, i.e., by seizure. *In re CJL,* 71 B.R. 261, 264-65 (Bankr.D. Or.1987); *Matter of Zimmerman,* 69 B.R. at 438 n. 1.

Bank One had never restricted or seized funds from Bergner's account before it seized the $31,207,000. Therefore, any security interest in Bergner's account arising under the Standby Letter of Credit Agreement was unperfected until seizure. The perfection by seizure was a transfer subject to avoidance, occurring as it did within the 90 day preference period. 11 U.S.C. § 547(b). Consequently, this court holds that the transfer is avoidable in full. 11 U.S.C. § 547(b)(5).

Liberty

As with the AMC letter of credit and the funds seized to pay the draw, the five elements of 11 U.S.C. § 547(b) must be analyzed with respect to the Liberty letter of credit and the funds seized for payment to Bank One.

1. *To or for the benefit of a creditor.*

As was the case with the AMC letter of credit, the account debit of $6,358,000 on the day of filing was a transfer to Bank One. The funds were posted to the bank's internal "Cash Letter of Credit Account," which was itself debited as Liberty drew on its letter of credit from time to time postpetition.

When these funds were seized on August 23, 1991, Liberty had not presented documents to draw on the letter of credit issued on July 29, 1991. Nevertheless, Bank One was a creditor of Bergner's because it had at least a contingent claim on the date of filing arising under the letter of credit. This is sufficient to make Bank One a creditor within the meaning of 11 U.S.C. § 547(b)(1). *See also* 11 U.S.C. §§ 101(5)(a), (10). Moreover, the insolvency of Bergner, followed by the bankruptcy filing, was an event of default under the Liberty letter of credit. That insolvency matured Bank One's obligation to Liberty under the letter of credit, thereby maturing Bergner's obligation to pay Bank One before the draw. Even if a contingent creditor were not a "creditor" under 11 U.S.C. § 547(b)(1), a creditor having a mature debt such as Bank One's does qualify.

The account debit was also a transfer "for the benefit of" Bank One since it gave the bank a fund from which to satisfy its own obligation to Liberty. This alone is sufficient to meet the requirement of 11 U.S.C. § 547(b)(1).

2. *For or on account of an antecedent debt owed by the debtor before such transfer was made.*

At the time Bank One debited Bergner's account for $6,358,000, Liberty had not presented documents to draw on its letter of credit. Bank One had not paid Liberty, and the debtor did not owe Liberty anything. From these facts, the bank infers that there was no "antecedent debt" when it seized the funds on the day of filing.

As was stated above, a contingent debt does satisfy the requirement of an antecedent debt under 11 U.S.C. § 547(b)(2). However, Liberty had a right to draw on the letter because of Bergner's insolvency and bankruptcy, and such a draw was a virtual certainty. Under the letter of credit agreement, payment by Bergner was required before Liberty drew, not after, which made the debt no longer contingent. Therefore, this court holds that Bergner's obligation to Bank One for the Liberty letter of credit was an antecedent debt under 11 U.S.C. § 547(b)(2).

3. *Made while the debtor was insolvent.*

This is not disputed by the parties. The debtor was insolvent at all times during the 90 days before filing.

4. *Made within 90 days before the date of filing the petition.*

It is undisputed that the transfer in question was made before the petition was filed and on the same date.

5. *That enables the creditor to receive more than it would in a chapter 7 case if the transfer had not been made.*

As was stated earlier, unsecured creditors would have received nothing if the Liberty seizure had not occurred and the debtors had filed petitions under chapter 7. The bank argues again it was fully secured, because this time it took a security interest in the debtor's account when it issued the new letter of credit on July 29, 1991, and the actual perfection by demand or by seizure was substantially contemporaneous. 11 U.S.C. § 547(c)(1). However, the letter from Bank One to Bergner outlining their agreement for issuance of the new letter stated that "on or before January 31, 1992, the entire $12,000,000 credit facility *will be* collateralized. . . ." (emphasis added). It did not say the letter of credit *is now* collateralized. The letter of credit would be collateralized in the future, but it was not collateralized when the letter was issued. Consequently, the subsequent perfection when the account was seized on August 23, 1991, is subject to avoidance for the same reasons that the perfection of the bank's security interest in the account for recovery of amounts due AMC was avoidable. These facts are in stark contrast with the facts of *Pine Top Ins. Co. v. Bank of Am. Nat'l. Trust and Sav. Ass'n., et al.*, 969 F.2d 321 (7th Cir.1992), in which the loan agreement called for granting of a security interest when the obligation was incurred.

If the bank had not seized the debtor's funds on the date of filing, paying itself 100 cents on the dollar, and if the debtor had filed chapter 7 cases, the bank as an unsecured creditor would have received nothing. Therefore, as with the seizure of funds for the AMC letter of credit, the transfer for the Bank's Liberty obligation meets the criterion for avoidability under 11 U.S.C. § 547(b)(5).

Creditor's Defenses – 11 U.S.C. § 547(c) [2]

Once the plaintiff has established that all of the elements of 11 U.S.C. § 547(b) exist, the creditor has the

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[2] (c) The trustee may not avoid under this section a transfer –

(1) to the extent that such transfer was –

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange;

(2) to the extent that such transfer was –

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms;

(3) that creates a security interest in property acquired by the debtor –

(A) to the extent such security interest secures new value that was –

burden of proof to show by a preponderance of the evidence that the transfer is not avoidable because a

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(i) given at or after the signing of a security agreement that contains a description of such property as collateral;

(ii) given by or on behalf of the secured party under such agreement;

(iii) given to enable the debtor to acquire such property; and

(iv) in fact used by the debtor to acquire such property; and

(B) that is perfected on or before 20 days after the debtor receives possession of such property;

(4) to or for the benefit of a creditor, to the extent that, after such transfer, such creditor gave new value to or for the benefit of the debtor –

(A) not secured by an otherwise unavoidable security interest; and

(B) on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor;

(5) that creates a perfected security interest in inventory or a receivable or the proceeds of either, except to the extent that the aggregate of all such transfers to the transferee caused a reduction, as of the date of the filing of the petition and to the prejudice of other creditors holding unsecured claims, of any amount by which the debt secured by such security interest exceeded the value of all security interests for such debt on the later of –

(A)(i) with respect to a transfer to which subsection (b)(4)(A) of this section applies, 90 days before the date of the filing of the petition; or

(ii) with respect to a transfer to which subsection (b)(4)(B) of this section applies, one year before the date of the filing of the petition; or

defense under 11 U.S.C. § 547(c) applies. 11 U.S.C. § 547(g). Successful proof of any of these defenses results in an unavoidable transfer.

AMC

1. *Intended by debtor and creditor to be a contemporaneous exchange for new value and was a substantially contemporaneous exchange.*

Congress carved out an exception to avoidable preferences to protect transactions intended to be a

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(B) the date on which new value was first given under the security agreement creating such security interest;

(6) that is the fixing of a statutory lien that is not avoidable under section 545 of this title;

(7) to the extent such transfer was a bona fide payment of a debt to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination made in accordance with state or territorial law by a governmental unit, or property settlement agreement, but not to the extent that such debt –

(A) is assigned to another entity, voluntarily, by operation of law, or otherwise; or

(B) includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance or support; or

(8) if, in a case filed by an individual debtor whose debts are primarily consumer debts, the aggregate value of all property that constitutes or is affected by such transfer is less than $600.

11 U.S.C. § 547(c).

contemporaneous exchange for new value, provided the transfer is in fact a contemporaneous exchange for new value. 11 U.S.C. § 547(c)(1). "New value" is defined in 11 U.S.C. § 547(a)(2) as "money or money's worth in goods, services, or new credit, or release" of property previously transferred, provided the previous transfer is not itself avoidable. The definition specifically does not include an obligation substituted for an existing obligation, i.e., a rollover. 11 U.S.C. § 547(a)(2). A transaction qualifying for this exception stands alone; that is, the transaction under scrutiny is independent of an antecedent debt that the debtor owes the creditor.

No transaction constituting a contemporaneous exchange for new value occurred when Bank One seized the Bergner bank account. The only purpose for Bergner's deposit, which both parties knew would be swept up by the bank, was to pay Bergner's obligation on the letter of credit; there is no evidence Bergner intended by the deposit to purchase a credit balance at AMC. Nothing in the affidavits presented by the bank supports any other purpose for the payment/deposit but to pay Bergner's obligation to Bank One.

More importantly, upon seizure of the funds when the transfer occurred, Bank One did not incur a contemporaneous corresponding obligation to Bergner, which would be necessary for a successful defense under 11 U.S.C. § 547(c)(1). The bank's only obligation was to AMC, which it paid. The bank neither intended to transfer anything to Bergner, nor did it in fact transfer anything to Bergner at the time of the seizure. Therefore, there was no contemporaneous exchange for new value.

2. *Debt was incurred in ordinary course of business affairs of debtor and creditor, and payment is made in ordinary course of business affairs of debtor and creditor and according to ordinary business terms.*

There are three necessary elements for the "ordinary course" defense under 11 U.S.C. § 547(c)(2), all of which must be met for a creditor to resist disgorgement of an otherwise avoidable preference. The first, that the debt be incurred in the ordinary course of the business affairs of the debtor and creditor, is met here. 11 U.S.C. § 547(c)(2)(A). It is undisputed that the parties established a substantial letter of credit relationship over the two years preceding the bankruptcy.

The second requirement is that the debt be paid in the ordinary course of the business affairs of the debtor and creditor. This defense was intended to leave normal business relations undisturbed and to avoid transfers brought about only by unusual actions taken by the debtor or creditor that resulted in a creditor obtaining a relatively better position than other similarly situated creditors. *See In re Energy Co-op., Inc.*, 832 F.2d 997, 1004 (7th Cir.1987), citing legislative history. In *Matter of Tolona Pizza Products Corp.*, 3 F.3d 1029, 1032 (7th Cir.1993), the court required that for a creditor to be protected from having to disgorge a prepetition transfer, the transfer or payment should "conform to the norm established by the debtor and the creditor in the period before, preferably well before, the preference period." While transactions need not occur often to be found in the ordinary course, the same court said "a creditor asserting § 547(c)(2) must show that the debtor incurred its debt and paid the

creditor in ways similar to other transactions." *In re Energy Coop., Inc.*, 832 F.2d at 1004 (citations omitted).

This court's colleague in *Matter of Milwaukee Cheese Wisconsin, Inc.*, 164 B.R. 297, 307 (Bankr.E.D.Wis.1993) (citations omitted), identified four tests to examine the circumstances surrounding the challenged payment. Each test might be probative of the parties' prior relationship in determining what was ordinary for the parties. These are particularly illuminating when applied to the undisputed facts in this case:

> "(1) whether the transfer was in an amount more than usually paid." Neither party suggested there was a prior payment by Bergner that even approached $31,207,000, and this court will boldly characterize this as an unusually substantial amount.
>
> "(2) whether the payments were tendered in a manner different from previous payments." There is no allegation that Bank One had ever involuntarily seized Bergner's bank account for payment of an obligation.
>
> "(3) whether there appears to be any unusual action by either the debtor or creditor to collect or pay the debt." This factor is most telling. Bergner borrowed $31,000,000 from Swiss Bank to make the deposit, and Bank One seized the funds. Before doing so, Bank One had cancelled the letter of credit, thereby precipitating the event of default. This was not standard conduct of the parties.

> "(4) whether the creditor did anything to gain an advantage in light of the debtor's deteriorating financial condition." Involuntary seizure of a bank account gave the bank a significant advantage over other creditors.

The third element of the 11 U.S.C. § 547(c)(2) defense is that the payment be made according to ordinary business terms. This requires inquiry into "the *range* of terms that encompasses the practices in which firms similar in some general way to the creditor in question engage, and that only dealings so idiosyncratic as to fall outside that broad range should be deemed extraordinary and therefore outside the scope of subsection C." *Matter of Tolona Pizza Prod. Corp.*, 3 F.3d at 1033. The bank's officer, Thomas Gaglione, stated in his affidavit that it was within the ordinary course of the business of banks issuing standby letters of credit to refuse to renew those letters on expiration, to demand prepayment of drafts, and to ask customers how they wish to pay for drafts. Such practices may be common in the banking industry. However, he also stated in his deposition, "No one expects a standby letter of credit to be drawn."

Conspicuously absent from Mr. Gaglione's affidavit is any assertion that Bergner gave instructions for debiting the account. The involuntary seizure of funds in an account may be something banks commonly do to protect their legal rights. However, there was no assertion by Bank One or its experts that such a seizure is a common industry practice during the ongoing letter of credit relationship or at its ordinary termination.

This is simply not the sort of transaction intended to be protected by 11 U.S.C. § 547(c)(2); it is precisely the

type of "idiosyncratic" exercise of creditor muscle that 11 U.S.C. § 547 was designed to avoid. *Matter of Tolona Pizza Products*, 3 F.3d at 1033.

Although a deposit to a bank account can be a transfer to the bank, unrestricted bank accounts usually are considered funds of the depositor. *Matter of Prescott*, 805 F.2d at 729. Banks cannot deal with those funds without the permission of the depositor except in unusual circumstances, usually related to the debtor's precarious financial circumstances. Nothing in Bank One's submissions of proof has alleged that banks ordinarily take control over depositors' accounts, even when the depositor has a loan outstanding, as was done here.

Therefore, the seizure of Bergner's account and payment to itself for the AMC wire was outside the ordinary course of business or financial affairs of the debtor and the transferee, and the resulting transfer was not made according to ordinary business terms. 11 U.S.C. § 547(c)(2)(B), (C).

3. *To the extent that after such transfer, creditor gave new, unpaid, unsecured value to debtor.*

This subsection, 11 U.S.C. § 547(c)(4), was raised by the bank but is inapplicable to the facts. This defense requires that after the transfer, the creditor gave new value to the debtor, and the new value was not paid for ("on account of which new value the debtor did not make an otherwise unavoidable transfer to or for the benefit of such creditor"). 11 U.S.C. § 547(c)(4)(B); *Matter of Century Brass Prod., Inc.*, 71 B.R. 77, 78-79 (Bankr.D.Conn.1987). Bank One was paid in full before filing, so there was no

new value given by Bank One after the transfer for which it was unpaid.

Other subsections of 11 U.S.C. § 547(c) are likewise inapplicable to the facts.

Liberty

1. *Intended by debtor and creditor to be a contemporaneous exchange for new value and was a substantially contemporaneous exchange.*

Bank One argues that the transfer the court should focus on with respect to the Liberty payment is issuance of the new letter of credit on July 29, 1991. The bank maintains that the issuance of this new letter served as consideration for the granting of a security interest in the account, and that the perfection of the security interest by restricting the account, i.e., requiring a minimum balance of $6,400,000, constituted contemporaneous perfection. If the granting of the security interest was a contemporaneous exchange for new value protected by 11 U.S.C. § 547(c)(1), then the subsequent seizure would likewise be protected. 11 U.S.C. § 547(b)(5).

The bank cites *Pine Top Ins. Co. v. Bank of Am. Nat'l. Trust and Sav. Ass'n., et al.*, 969 F.2d 321 (7th Cir.1992), in support of this theory. A careful reading of *Pine Top*, however, reveals that the parties in that case intended the granting of a security interest when the loan was made. The parties in this case did not. As was stated earlier, the agreement states that the letter of credit obligation would be collateralized in the future, not at the time of issuance.

The requirement of a minimum balance, merely a demand and not actual control, came when the bank learned of Bergner's problems with Swiss Bank two days after the letter of credit was issued. Perhaps the bank would not have issued the letter had it known about the precarious nature of the revolving line of credit, but the fact remains that the bank did not know, and it did not take or perfect a contemporaneous security interest on July 29, 1991. Even if the demand for a minimum balance were sufficient for perfection, which this court is satisfied it is not, the granting of the security interest in the account and perfection were not contemporaneous with issuance of the letter. *See In re CJL*, 71 B.R. at 264-66.

Bank One has argued that the new letter of credit issued July 29, 1991, was not a renewal of the old expired letter of credit and that it constituted "new value." This court is satisfied that, except for the $500,000 increase in the amount payable to Liberty, the issuance of the new letter merely took the place of the old letter. Issuance of the new letter continued the obligation of Bank One to Liberty uninterrupted, and it prevented a draw under the old letter, a significant benefit to Bank One. The new letter was "substituted for an existing obligation" of Bank One to Liberty as that term is used in 11 U.S.C. § 547(a)(2), and it is not new value. In any event, whether the issuance of the new letter is new value relates to Bank One's obligation to Liberty, not Bergner's obligation to Bank One. Only the latter is the subject for recovery in this action, and whether the seizure satisfied Bergner's obligation to Bank One for a new or reissued letter of credit is irrelevant.

The decisive question is, if there was an exchange for new value, what was the *new* contemporaneous consideration that Bank One gave Bergner in exchange for the money seized? There was none, as Bank One had already obligated itself to pay Liberty when each letter of credit was issued. *Matter of Compton Corp.*, 831 F.2d at 590; *In re Security Services, Inc.*, 132 B.R. at 414. Thus, the analysis of the debit of Bergner's account on August 23, 1991, for the Liberty letter of credit is similar to the analysis for AMC. The debit was intended to reduce Bergner's obligation to Bank One, not to create a credit on Bank One's books for application to future insurance charges, because on August 23, 1991, Bergner had no obligation to pay Liberty for either a debt or as a prepayment for future services.

Therefore, neither the issuance of the July 29, 1991 letter of credit nor the subsequent seizure of Bergner's account to pay Bank One for future draws on the Liberty letter of credit were contemporaneous exchanges for new value within the meaning of 11 U.S.C. § 547(c)(1).

2. *Debt was incurred in ordinary course of business affairs of debtor and creditor, and payment is made in ordinary course of business affairs of debtor and creditor and according to ordinary business terms.*

As with the AMC letter of credit, the debt of Bergner to Bank One for the Liberty letter of credit was incurred in the ordinary course of the business of the debtor and the creditor. Also for the same reasons stated above, the debt was not paid in the ordinary course, nor was it paid according to ordinary business terms. Involuntary seizure of the account was, as between Bergner and Bank One,

highly unusual (although it had been done at least once previously with the AMC letter of credit). It was clearly done in response to Bergner's insolvency. The seizure was a form of self help that put Bank One in a superior position to other unsecured creditors. Therefore, the transfer was outside the ordinary course of business affairs of the debtor and creditor.

Similarly, ordinary business terms with respect to a bank account requires direction by the depositor, not involuntary seizure. *Matter of Prescott*, 805 F.2d at 729. For the same reasons applicable to the payment for the AMC letter of credit, the seizure for the Liberty letter of credit was outside ordinary business terms. 11 U.S.C. § 547(c)(2)(C).

3. *To the extent that after such transfer, creditor gave new, unpaid, unsecured value to debtor.*

As with the AMC letter of credit, 11 U.S.C. § 547(c)(4) is inapplicable to the seizure of Bergner's account for the Liberty letter of credit. The obligation was not unpaid at the time of filing, as is required for application of this defense.

Other subsections of 11 U.S.C. § 547(c) are likewise inapplicable to the facts.

Setoff – 11 U.S.C. § 553(b)[3]

Whether the two transfers in question are analyzed as preferences under 11 U.S.C. § 547 or prepetition setoffs of mutual obligations under 11 U.S.C. § 553, the result here is the same. Damages are calculated differently under the two statutes, but both are limited to the amount of the transfers. Damages under the setoff statute are the amount by which the creditor improved its relative position with respect to the debtor's and creditor's mutual obligations during the 90 day period before filing, but no more than the amount of the transfers. 11 U.S.C. § 553(b)(1). A comparison of the amount due the bank on the outstanding letters of credit with the bank account

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[3] (b)(1) Except with respect to a setoff of a kind described in section 362(b)(6), 362(b)(7), 362(b)(14), 365(h), 546(h), or 365(i)(2) of this title, if a creditor offsets a mutual debt owing to the debtor against a claim against the debtor on or within 90 days before the date of the filing of the petition, then the trustee may recover from such creditor the amount so offset to the extent that any insufficiency on the date of such setoff is less than the insufficiency on the later of –

(A) 90 days before the date of the filing of the petition; and

(B) the first date during the 90 days immediately preceding the date of the filing of the petition on which there is an insufficiency.

(2) In this subsection, "insufficiency" means amount, if any, by which a claim against the debtor exceeds a mutual debt owing to the debtor by the holder of such claim.

11 U.S.C. § 553(b).

balance 90 days before filing (the "insufficiency" comparison under 11 U.S.C. § 553(b)) results in a number that exceeds the amount of the two transfers.[4] Thus, damages are the amount of the transfers if either the preference or setoff statute is applied. The setoff statute does not provide for defenses found in 11 U.S.C. § 547(c), but the two statutes are analogous. *See Matter of Prescott*, 805 F.2d at 730. Both are intended to avoid transactions that place a creditor in a better position than it would have been at the time of the debtor's bankruptcy absent the transfer or setoff.

The seizures of Bergner's account and the cancellation of Bergner's indebtedness on Bank One's books, which the parties agree took place in each instance shortly after the account was debited, are appropriately designated setoffs, i.e., the offset of mutual debts. The bank owed Bergner the amount in the account as its depositor, and Bergner owed Bank One for draws that had taken place on the AMC letter of credit and for Liberty's inevitable draw. Each seizure and corresponding book entries constituted a setoff of those mutual debts, and Bank One's letter to Bergner of August 23, 1991, so states. The July 19, 1991 events resulting in the AMC payment were essentially the same.

Taken in isolation, the seizure of the accounts, by debit or memo posting, might be considered "transfers" as they resulted in the perfection of the bank's security interest. The security interest had arisen in the Standby Letter of Credit Agreement of July 26, 1989, but the

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[4] *See* Bergner brief filed February 22, 1994, p. 27, n. 7.

interest was unperfected until seizure occurred. The perfection of a security interest results in a transfer that would require analysis under 11 U.S.C. § 547(b) and consideration of the bank's defenses under 11 U.S.C. § 547(c), as was shown above.

Under the instant facts, the characterization of events as a transfer or a setoff results in a distinction without a difference. Bergner is entitled to recover the amount seized under either statute.

Double Recovery – 11 U.S.C. § 550(d)

Bank One argues that recovery by Bergner of a preference or avoidable setoff permits the debtor to recover twice: first, Bergner received the benefits of the AMC credit and the goods the credit bought, and Bergner received insurance coverage as Liberty drew down its letter of credit; second, if Bergner prevails in this action, it would also receive the funds that previously purchased those assets.

Section 550(d) allows only a single recovery under subsection (a), which designates transferees from whom recovery may be sought. Bank One is the initial transferee of the funds taken from Bergner, and AMC and Liberty are transferees of the initial transferee. 11 U.S.C. § 550(a). Subsection (b) of § 550 provides that a subsequent transferee who acquires a transfer for value, including satisfaction of an antecedent debt, is not subject to recovery. As Bank One had independent antecedent debts to AMC and Liberty by virtue of its letters of credit, which were satisfied by the bank's payments, Bergner cannot recover from those entities. 11 U.S.C. § 550(b)(1).

Bergner cannot pursue AMC and Liberty as creditors who received indirect transfers or for whose benefit transfers were made. 11 U.S.C. § 547(b)(1). AMC and Liberty were not Bergner's creditors when payment was made. They were only Bank One's creditors.

Had Bank One not seized the account on those two occasions, Bergner would have had precisely what it now seeks, the funds in its account. Bank One's independent obligations would have eventually inured to Bergner's benefit because of Bank One's payments, but as the bank points out, Bergner had no enforceable right to those benefits by virtue of having its bank account seized. Any benefit to Bergner arose as a result of Bank One satisfying its own liabilities, not on account of the transfer from Bergner.

In sum, Bergner has only one preference defendant, actual or potential, and only one recovery. *In re Skywalker, Inc.*, 155 B.R. 526, 530 (9th Cir. BAP1992). This satisfies the requirement of a single recovery as provided by 11 U.S.C. § 550(d).

Prejudgment Interest

Bergner has asked the court to award prejudgment interest on its avoided transfers. No provision in the Bankruptcy Code provides for prejudgment interest, and such an award is not "mandatory or automatic." *In re Energy Co-op., Inc.*, 130 B.R. 781, 792 (N.D.Ill.1991), *aff'd* 832 F.2d 997 (7th Cir.1987).

If such interest were awarded, it would only be from the time Bergner made demand for return of the preferences, and the commencement of this action would be an

appropriate starting point. The court believes no interest should be paid from the time of transfer to the commencement of the action because, up until that point, the payment was legal and unavoidable in all respects. A preference is not an avoidable preference until the court determines that it is.

Interest is to compensate the debtor for its inability to use the funds while in the transferee's control, but it is unlikely that Bergner would have had use of the money subsequent to the transfer. Bergner's unsecured creditors received $.33 on the dollar under the joint plan. Had the debtor had sufficient cash, chances are that number would have been higher. As debtor would have had to fund the plan, it is doubtful that Bergner would have retained the funds. Consequently, at this point, prejudgment interest would be a windfall to Bergner.

Accordingly, prejudgment interest will be denied.

Conclusion

For the reasons stated herein, there is no dispute as to any material fact, and the plaintiff is entitled to judgment as a matter of law. Fed.R.Bankr.P. 7056. The plaintiff's motion for summary judgment is granted in its entirety, and the defendant's motion for summary judgment is denied. Plaintiff shall have judgment against the defendant for $37,565,000, plus costs. Prejudgment interest is denied.

Counsel for Bergner will prepare the order for judgment consistent with this decision.

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

Chicago, Illinois 60604

Decided June 3, 1998

Before

Hon. HARLINGTON WOOD, JR., *Circuit Judge*

Hon. DIANE P. WOOD, *Circuit Judge*

In the Matter of: P. A. BERGNER & COMPANY, etc., et al., *Plaintiff-Appellee, Cross-Appellant,* Nos. 96-3879 & 96-3937 *v.* BANK ONE, MILWLAUKEE, N.A., *Defendant-Appellant-Cross-Appellee.*	Appeal from the United States District Court for the Eastern Division of Wisconsin No. 95-C-1087 **J. P. Stadtmueller,** *Chief Judge.*

ORDER

On consideration of the petition for rehearing with suggestion for rehearing *en banc* filed by counsel for the Defendant-Appellant and Cross-Appellee Bank One, Milwaukee, N.A. on April 23, 1998, and the answer filed thereto by counsel for the Plaintiff-Appellee and Cross-

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*Honorable Walter J. Cummings sat on the original panel that heard this matter, but later recused himself from consideration of the petition for rehearing and suggestion for rehearing *en banc*, and therefore took no part in its consideration.

Appellant on May 13, 1998, a majority of the members of the original panel have voted to **DENY** the petition for rehearing. No judge in regular active service requested a vote on the suggestion for rehearing *en banc*. Accordingly,

IT IS ORDERED that the petition for rehearing and suggestion for rehearing *en banc* be, and the same is hereby, **DENIED.**

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In the Matter of: P.A. BERGNER & CO. HOLDING COMPANY, et al., Debtors.	Jointly Administered Case Nos. 91-05501 through 91-05516 (RAE) Chapter 11
P.A. BERGNER & CO., (formerly d/b/a P.A. Bergner & Co. of Illinois) Plaintiff, vs. BANK, ONE, MILWAUKEE, NA, Defendant.	Adversary Proceeding No. 92-2323

AFFIDAVIT OF THOMAS A. GAGLIONE

[Filed June 15, 1994]

STATE OF WISCONSIN)
) ss.
MILWAUKEE COUNTY)

Thomas A. Gaglione, being first duly sworn, on oath, deposes and states as follows:

1. I am a Vice President of Bank One, Milwaukee, NA ("Bank One" or the "Bank") and have been the manager of the Bank's International Department for six years. I have worked in international banking for more than thirteen years. In my capacity as manager of the International Department, one of my primary responsibilities is supervision of the Bank's documentary credits which include standby letters of credit. This affidavit is based on my personal knowledge, except as otherwise indicated herein.

2. As part of its regularly conducted banking activities, Bank One has in the past and continues to issue standby letters of credit ("LOC") for customers who commonly require them to assure payment for goods purchased by those customers.

3. As part of Bank One's regularly conducted banking activities, a customer which requests the issuance of an LOC executes and delivers a standby letter of credit agreement on a standard preprinted form regularly used by the Bank. The Standby Letter of Credit Agreement between Bank One and Bergner was the same standard form used for other customers.

4. The terms and provisions of Irrevocable Standby Credit, No. 55188, issued on July 31, 1990, for the benefit of the Associated Merchandising Corporation ("AMC LC"), are standard terms and provisions commonly utilized by Bank One in its transactions with other customers for whom the Bank issues LOCs.

5. It is a regular banking practice for Bank One to include a provision in a LOC permitting Bank One to give the beneficiary notice of at least 60 days prior to the

expiration date of Bank One's election not to extend the credit.

6. It is a regular banking practice for Bank One to make a credit decision based on financial information related to a customer not to extend a LOC and to give notice to the LOC beneficiary of Bank One's election not to extend the LOC for any period.

7. It is a regular banking practice for Bank One to issue a LOC containing a provision permitting the beneficiary to draw on the LOC during the time following the giving of notice by Bank One of its election not to extend the credit and prior to the expiration date.

8. It is a regular banking practice for Bank One not to pay draws on a LOC with its own funds and subsequently to seek reimbursement from the customer. As a matter of fact, I am unaware of any instance in my experience at Bank One where the Bank paid a beneficiary of a standby letter of credit with its own funds and then later sought reimbursement from a customer.

9. When a conforming draw is submitted on an LOC, it is the regular banking practice at Bank One to notify the customer of the draw and inquire as to how the customer proposed to fund the draw.

10. It is the regular banking practice at Bank One for the customer to deposit funds in its account at the Bank which are sufficient to cover the funding of the draw.

11. It is the regular banking practice at Bank One to commence the funding of a draw by memo posting the customer's account in the amount of the draw. The memo

posting procedure provides a temporary record pending formal posting at the end of the day. The memo posting process assures that the funds in the customer's account are unavailable for any other use, other than funding the wire transfer.

12. It is the regular banking practice at Bank One to fund the draw of a standby LOC by wire transferring funds from the customer's account to the beneficiary.

13. Prior to issuance of the AMC LC, Bank One had previously issued other letters of credit for Bergner's account, each containing special conditions similar to those contained in the AMC LC.

14. In the regular course of its banking activities, Bank One receives wire transfers of large sums of money from other banks.

15. Bergner's execution and delivery of the Standby Letter of Credit Agreement, Bank One's issuance of the AMC LC for Bergner's account, and Bergner's funding of the AMC LC were very similar to transactions involving LOCs with other Bank One customers, and were consistent with the Bank's regular banking practice relating to standby LOCs.

16. On July 29, 1991, the Bank issued a new standby letter of credit for the benefit of Liberty Mutual Insurance Company as Credit No. 55474 in the amount of $6,358,000. This was not a renewal or extension of the previous letters of credit which had been issued for the benefit of Liberty Mutual Insurance Company (Credit Nos. 54796, 54901, 54986 and 55226, respectively). When a letter of credit is renewed or extended, it is the regular

banking practice at Bank One for the letter of credit to retain the same credit number.

Dated at Milwaukee, Wisconsin this 15th day of June, 1994.

/s/ Thomas A. Gaglione
Thomas A. Gaglione

Subscribed and sworn to before
me this 15th day of June, 1994.

/s/ [Illegible]

Notary Public, State of Wisconsin.
My commission: is permanent

UNITED STATES BANKRUPTCY COURT
EASTERN DISTRICT OF WISCONSIN

In the Matter of P.A. BERGNER & CO. HOLDING COMPANY, et al., Debtors.	Jointly Administered Case Nos. 91-05501 through 91-05516 (RAE) and Case No. 93-20736 (RAE) (Chapter 11)
P.A. BERGNER & CO. Plaintiff, v. BANK ONE, MILWAUKEE, NA, Defendant.	Adv. Proc. No. 92-2323

AFFIDAVIT OF JAMES EDWARD BYRNE

State of Maryland

County of Montgomery

Comes now the Affiant, JAMES EDWARD BYRNE, who, having been first duly sworn, on oath, states the following:

1. I am an adult citizen of the United States of America, presently residing at 20405 Ryecroft Court, Gaithersburg, Maryland. My personal and professional background is set forth in the attached resume. (Attachment "A").

2. This Affidavit is based upon my personal knowledge, except as otherwise indicated herein, and the Affidavit is submitted to the Court, for consideration in resolving the pending motions for summary judgment in this proceeding.

3. I have been requested by defendant, Bank One, Milwaukee, N.A., to render an analysis and opinion regarding the relationship and actions of issuer, applicant and beneficiary under standard letter of credit practice with regard to the issuance, extension, and funding of standby letters of credit utilized to assure performance of financial obligations to pay for goods and whether the relationship and actions of defendant under the letter(s) of credit at issue in the instant action were consistent with this standard practice.

4. In connection with my analysis and opinion, I have reviewed and relied on the following documents:

a. Standby Letter of Credit Agreement dated July 26, 1989;

b. The application for the issuance of the AMC Letter of Credit;

c. Irrevocable Standby Credit dated July 31, 1990 and Amendments;

d. Notice of non-renewal dated May 23, 1991;

e. Documents presented by AMC under Irrevocable Standby Credit;

f. Bergner's Motion for Summary Judgment (Memorandum of Law);

g. Bank One's Cross-Motion for Summary Judgment (Memorandum of Law);

h. Bergner's Reply Memorandum of Law;

i. Section 547 of the Bankruptcy Code.

5. I have also relied on my experience with and knowledge of standard letter of credit practice as it relates to both commercial and standby letters of credit in the United States and throughout the world, derived from my regular interaction with bankers, applicants, beneficiaries, carriers, and freight forwarders, and their attorneys, my regular exchange of views with other experts in the field, and my research, studies, and writings.

6. Letters of credit are commonly used as vehicles for the payment and assurance of performance or payment in all segments of trade and commerce. While anyone can issue a letter of credit, they are almost always issued by banks or financial institutions, and then, usually only the major banks, because of their credit-worthiness and the expertise necessary to handle letter of credit operations. Bank One is among the major issuers of letters of credit in the United States and it is an active member of the trade association of U.S. banks, the U.S. Council on International Banking, Inc., which represents approximately 350 of the major banks in the U.S. engaged in letter of credit practice. One of the goals of this organization is to provide teaching and to assure standardization of letter of credit practices in the U.S. and internationally.

7. The letter(s) of credit involved in the instant action are performance standby letters of credit which the issuer, Bank One, assures the respective beneficiary that it

will pay the amount of the credit upon the timely presentation of conforming documents stipulated in the credit. Under such arrangements, it is expected that the applicant will pay the beneficiary directly and that the letter of credit will not be drawn upon except in the event of default.

8. Both commercial and standby letters of credit are regularly used in the retail industry in the U.S. on behalf of retailers to assure payment to wholesalers and suppliers of goods. While there are not figures available which differentiate letter of credit volume by industry, the face amount of a given standby will typically be large. The use of the letter of credit in the instant action in the manner indicated and for the amount stated was in accord with normal and accepted practice both for the banks and the industry.

9. Letter of credit practice is premised on the understanding that the issuer's undertaking to the beneficiary embodied in the letter of credit is not affected by events which occur in the relationship between the applicant and beneficiary or those which occur between the issuer and applicant. This so-called doctrine of independence reflects a fundamental mercantile notion that a banker's word is his or her bond, must be fulfilled according to its own terms and conditions taken by themselves, and cannot be affected or excused by legal defenses imported from other related transactions.

10. This notion is reflected in the compendium of rules and customary practices known as the Uniform Customs and Practice for Documentary Credits produced by the international banking community through the

mechanism of the International Chamber of Commerce which embody its common wisdom and collective understanding of letter of credit practice. The applications and credit(s) in the instant action were expressly made subject to the 1983 revision of the UCP (ICC Publication No. 400). The UCP and letter of credit practice are the principal source of regulation for this quintessentially international instrument whose legal character is largely shaped by mercantile rules and practices.

11. The UCP provides, for example, that the undertaking in the credit is "separate" from the transactions which give rise to them (UCP 400 Article 3), that the credit transaction focuses on documents rather than the actual performances to which the documents relate and which they represent (UCP 400 Article 4), and that the "beneficiary can in no case avail himself of the contractual relationships existing between the banks or between the applicant for the credit and the issuing bank" (UCP 400 Article 6).

12. This type of promise is the source of the letter of credit's international reputation as a dependable source of payment. It is 1) a promise typically by a third party; 2) documentary in character; 3) not subject to defenses based on the transaction which gave rise to is; and, 4) it effects transfer of funds pending ultimate resolution of non-documentary, factual disputes between the parties to those transactions. It is from this mercantile notion of independence that the law has drawn to accord the letter of credit such a high degree of abstraction.

13. However, this notion of independence does not obtain in practice in the relationship between the applicant and the beneficiary. Their relationship turns upon the contractual undertaking between them as determined in light of the facts and circumstances of their performance.

14. In the understanding of the letter of credit community, the same principle applies to the relationship between the applicant and the issuer. That transaction is also separate from the undertaking embodied in the letter of credit but is also not itself independent. Its performance turns on non-documentary performances by the applicant and the issuer respectively. Since the issuer's undertaking to the beneficiary is both separate and independent from the issuer/applicant relationship, the applicant cannot assert rights or defenses to which the beneficiary is privy vis a vis the issuer. It is a fundamental operating principle of letter of credit practice that the applicant cannot avail itself of the rights of the letter of credit beneficiary (i.e., it is not a third party beneficiary of the L/C beneficiary) but its rights and obligations are determined in light of the agreement between issuer and applicant.

15. The agreement between issuer and applicant (also commonly referred to as "customer" or "account party") is typically reflected in an agreement between the parties which is sometimes known as an "Application". This term reflects the understanding that the issuance of the credit is "for the account of" the applicant, almost always a customer of the issuer, who "applies" to the issuer for its issuance and as, consideration for its issuance, undertakes to pay predetermined fees and charges.

16. The application entitled "Standby Letter of Credit Agreement" dated 26 July 1989 is a typical instance of a letter of credit application with terms which are commonly accepted and used in the banking industry. It is a master agreement and specific applications must be made under it for issuance of specific credits. These applications reflect the precise terms desired in each credit.

17. Of particular significance, the Application provides in Paragraph 1 that the applicant or customer will pay the amount of a drawing at or before presentation of the draft. Such language is typical in the banking industry for applications regarding credits which are not to be funded upon the occurrence of a drawing by a loan to the applicant. As indicated, this provision reflects the understanding of Bank One, the applicant and its guarantor company that, in the event of a drawing on the letter of credit, the bank would pay with the applicant's funds. In this sense, the agreement is understood in the industry as analogous to the right of exoneration as between principal and surety under which the surety may compel the principal to provide it with funds but may not assert the principal's failure to do so as a defense against the creditor. It is the common understanding of letter of credit bankers that in such cases, the funding of the credit is to be from the funds provided by the applicant at the time of the drawing and not to be from monies loaned by the bank.

18. As issued, the letter of credit reflected the terms and conditions reflected in the Application dated 30 July 1990. In its form and provisions, it was typical of standby letters of credit issued to assure performances.

19. The provisions in the credit, reflecting the requested language in the Application, which relate to the expiry and termination of the credit are commonly used in the banking industry. As is the case with all commercial undertakings, letters of credit are not perpetual in duration.

20. The credit(s) in the instant case contained a clause commonly known as an "evergreen" or automatic extension clause by which the credit would be automatically extended on an annual basis. In order to comply with safety and soundness concerns, the issuer was given the option of electing not to renew the credit in which case it would have to give formal notice to the beneficiary prior to a specified time before the expiry. In the credit(s) at issue here, the notice was required prior to two months before the automatic renewal date. A notice prior to two months is not uncommon in the banking industry. In such cases, it is usual for the issuer to commence an annual credit review a set time prior to the notice deadline in the credit.

21. The letter from the issuer to the beneficiaries giving notice of non-renewal suggests that such a credit review was undertaken and that a credit decision was made not to extend the letter of credit undertaking. The fact that it did reassess and decided not to renew does not suggest that the decision was made out of the ordinary course of business. Nor did this decision violate any agreement present in the master Application (Standby Letter of Credit Agreement). In the first place, the provisions echoed the language requested by the applicant in the application dated 17 July 1989. Secondly, the master

Application carefully reserves the right to the issuer to review its credit decision on a regular basis.

22. The non-renewal of the credit may place the beneficiary at a disadvantage. Unless it draws upon the credit prior to its expiry, it will lose the protection afforded by the credit. It may not be able to draw under the terms and conditions of the credit, however, because the applicant may not be in default. Therefore, it is common practice in the letter of credit industry for such credits to include special conditions permitting a drawing in the event of non-renewal of the credit.

23. It is important to recognize that in letter of credit practice and under this credit the applicant has several options besides permitting the beneficiary to draw down the letter of credit. It could, for example, replace the credit with another standby, replace the credit with another form of independent financial assurance, or with other collateral, or it could pay the amount of the credit to the beneficiary either directly or through the banking facilities of the issuer. In the instant case, all of these options were open to the applicant and it exercised the option of paying the beneficiary with its funds through the wire transfer facilities of Bank One. Since there was no default in payments or amounts outstanding at this time, the applicant "default" which led to the drawing on the credit was prospective in character rather than actual.

24. In my considered opinion, the letter of credit Application, its terms and conditions and specifically the funding provisions by which the applicant was expected to fund any drawing under the credit, the decision to

issue the letter of credit in the form used including the automatic extension provision, the review of the status of the applicant, the decision not to extend the letter of credit, the notice of non-renewal, the draw by the beneficiary and the funding of the drawing by the applicant in accordance with the terms of the Application, are common in commerce, banking practice, and the retail industry, consistent with standard letter of credit practice and fairly reflect the reasonable expectations of parties to such transactions. Further Affiant saith not.

Respectfully submitted,

/s/ James E. Byrne
James E. Byrne
Affiant

I, the undersigned, certify that the above Affiant, personally known to me, having been duly cautioned and sworn, made the above statement and executed it this 22 day of June, 1994 and I am authorized under the laws of MD to verify this execution of this document.

/s/ Courtney A. Fleming
A Duly Authorized Person to
Administer Oaths

COURTNEY A. FLEMING
NOTARY PUBLIC STATE
OF MARYLAND
My Commission Expires
February 8, 1996

LETTER OF CREDIT PLAN

AGREEMENT FOR
PREMIUM PAYMENTS NATIONAL RISK #1192

This is an agreement between Liberty Mutual and the Policyholder with regard to payment of premium for the following insurance policies:

Policy No.	Insurer	Insured
WC2-614-004047-810	LMF	P. A. Bergner & Co.
RG1-614-004047-840	LM	
AS1-614-004047-850	LM	
AV1-614-004047-880	LM	

1. *Liberty Mutual.* The term "Liberty Mutual" means Liberty Mutual Insurance Company, Liberty Mutual Fire Insurance Company, and Liberty Insurance Corporation, all of which are Massachusetts corporations having their principal place of business at 175 Berkeley Street, Boston, Massachusetts. Any of the above policies for which the insurer is designated "LM", "LMF" or "LIC" are issued by Liberty Mutual Insurance Company, Liberty Mutual Fire Insurance Company or Liberty Insurance Corporation. However, regardless of which company has issued a policy, this agreement will be satisfied if all payments are made to Liberty Mutual Insurance Company and if Liberty Mutual Insurance Company is named as "beneficiary" in any letter of credit issued under this agreement.

2. *Policyholder.* The term "Policyholder" includes all those listed above as "insured", or listed on any of the above policies as an "insured" or "named insured", and

all of them shall be jointly and severally liable for performance of the terms of this agreement and for the payment of premiums and all other obligations under the policies. Any notice required to be sent to the Policyholder shall be in writing and may be sent to the "first named insured", at the address indicated in this paragraph, on behalf of all those listed as "insured" above or on any of the above policies. The "first named insured" will make payment on behalf of all of them, unless the Policyholder and Liberty Mutual agree on some other arrangement. The "first named insured" shall be P. A. Bergner & Co. and its address is 331 W. Wisconsin Avenue, Milwaukee, WI ~~53206~~ 53203.

3. *Billed Premium.* Liberty Mutual will send the Policyholder 12 monthly premium invoices for $386,849 each, beginning on or about 10 days before the first day of August, 1990, and continuing monthly for the next 11 months, making a total of $4,642,188. The amounts of these invoices will be known as "billed premium". After each retrospective premium computation or annual audit, Liberty Mutual will send the Policyholder an invoice for "revised billed premium", determined as the sum of the following:

A. For those policies covered by this agreement (or the lines of insurance in such policies) which are subject to retrospective rating: The "retrospective premium" (as computed under the terms of the retrospective premium endorsement) after applying any dividend declared by Liberty Mutual.

B. For those policies covered by this agreement (or the lines of insurance in such policies) which are not subject to retrospective rating: The audited "premium", as defined in the policies, after applying any dividend declared by Liberty Mutual.

The amounts and due dates of "billed premium" may change if, after execution of this agreement, Liberty Mutual agrees to make other premium charges subject to this agreement.

4. *Premium Payable.* Liberty Mutual will send monthly notices of "premium payable" to the Policyholder on or about 10 days before the first day of each month, beginning on or about 10 days before the first day of August, 1990. The Policyholder will pay the amounts of "premium payable" monthly so that Liberty Mutual receives payment on or before the first day of each month. The "premium payable" amounts will consist of the following:

A. Variable expense – $19,500 per month for 21 months, making a total of $409,500.

B. Fixed expense – $26,303 per month for 12 months, making a total of $315,636.

C. Premium Taxes – $24,917 per month for 12 months, making a total of $299,004.

D. Excess premium – $36,359 per month for 12 months, making a total of $436,308.

E. Loss payments – $51,826 per month for the first 3 months and then an amount for each month equal to Liberty Mutual's actual paid losses for the third preceding month, such payments to continue until all outstanding

"ratable incurred losses" (as determined by Liberty Mutual) have been liquidated. "Ratable incurred losses" shall mean the sum of the actual paid losses and the reserves for unpaid losses as estimated by Liberty Mutual, subject to the occurrence maximum of the applicable loss limitation and, if applicable, maximum ratable loss provisions stated in the retrospective premium agreement.

F. Non-retro-rated premium – $2,646 per month for 12 months, making a total of $31,752.

On or about Month 22 and annually thereafter, the "premium payable" for variable expense will be recalculated using Liberty Mutual's "ratable incurred losses" in place of the estimated incurred losses for the same period. "Ratable incurred losses" shall mean the sum of the actual paid losses and the reserves for unpaid losses as estimated by Liberty Mutual, subject to the occurrence maximum of the applicable loss limitation and, if applicable, maximum ratable loss provisions stated in the retrospective premium agreement.

All of the above elements of "premium payable" will be estimated payments of the Policyholder's liability for premiums due under the policies covered by this agreement. The Policyholder's ultimate liability for premiums shall be determined by the provisions of the policies, including the retrospective premium provisions.

The amounts and due dates of "premium payable" may change if, after execution of this agreement, Liberty

Mutual agrees to make other premium charges subject to this agreement.

5. *Audit and Retrospective Adjustments.* Since the final charges for variable expense, fixed expense, excess premium, loss payments, and non-retro-rated premiums are subject to audit and/or retrospective adjustment, any overpayment of these charges, as determined at audit or retrospective adjustment, will be returned to the Policyholder as a credit against outstanding monthly "premium payable" after all other unpaid obligations of the Policyholder to Liberty Mutual have been met. Any underpayment of these charges, as determined at audit or retrospective adjustment, shall become due and payable immediately upon receipt of a "premium payable" bill for such underpayment.

If at the time of the final premium determination, the final "revised billed premium" is greater than the sum of the Policyholder's payments of "premium payable" received by Liberty Mutual, the difference will become due and payable immediately upon receipt of notice from Liberty Mutual to the Policyholder.

This cash flow plan runs for a maximum of 5 years. If a final premium determination has not been completed by the fourth retrospective adjustment issued in the fifth year, the plan reverts to an incurred basis. Any amount of unpaid premium will be due and payable immediately upon receipt of notice from Liberty Mutual to the Policyholder.

6. *Estimated Final Premium.* Since the obligations under this agreement are based on an "estimated final premium" and the "billed premium" (or "revised billed premium") and "premium payable" are subject to audit and/or retrospective adjustments at various development intervals, the "estimated final premium" will be calculated using the terms of the retrospective endorsement with estimated exposures and estimated ultimate losses.

Liberty Mutual shall have the option to revise the "estimated final premium" at anytime should the exposures and/or losses used for determining "estimated final premium" be less than the actual audited exposures or incurred losses. This option is available anytime up through and including the third retrospective adjustment.

7. *Late Payment Penalty Charge.* Should Liberty Mutual draw upon the letter of credit for "premium payable" amounts overdue as provided in Item 11., Liberty Mutual will impose a late payment penalty charge of 1½% per month on the overdue amount, starting from the due date.

8. *Letter of Credit.* To guarantee performance of its obligations under this agreement, the Policyholder shall deliver to Liberty Mutual a clean irrevocable letter of credit providing for negotiation credit by sight draft without notation in substantially similar form as the attached specimen. The letter of credit shall name Liberty Mutual as the beneficiary, shall be issued by a bank acceptable to Liberty Mutual, and shall be for a term of at least 12 months. The amount of the letter of credit shall be the difference between "estimated final premium" (or "revised estimated final premium") and the "premium

payable", as indicated on the attached schedule. If at anytime before the fourth retrospective adjustment, the Policyholder's outstanding liability – i.e. the "estimated final premium" or "revised estimated final premium" (as defined in Item 6. of this agreement) less any "premium payable" amounts paid to Liberty Mutual – is greater than the amount of the letter of credit, Liberty Mutual shall have the option to require the Policyholder to deliver an amendment to the existing letter of credit or an additional letter of credit (in substantially similar form as the attached specimen) issued by a bank acceptable to Liberty Mutual and for a term of at least 12 months, unless otherwise negotiated and agreed to in writing between Liberty Mutual and the Policyholder, within 30 days of notice to cover the amount of such excess.

If the fourth retrospective adjustment or subsequent retrospective adjustment indicates that the outstanding liability – i.e. the "revised billed premium" amount (as defined in Item 3. of this agreement) less any "premium payable" amounts paid to Liberty Mutual – is greater than the amount of the letter of credit, the Policyholder shall deliver an amendment to the existing letter of credit or an additional letter of credit (in substantially similar form as the attached specimen) issued by a bank acceptable to Liberty Mutual and for a term of at least 12 months, unless otherwise negotiated and agreed to in writing between Liberty Mutual and the Policyholder, within 30 days of notice to cover the amount of such excess.

9. *Substitute Letter of Credit.* No later than 60 days before the date of termination of a letter of credit, the Policyholder shall deliver to Liberty Mutual a substitute letter of credit (in substantially similar form as the attached specimen) with Liberty Mutual as the beneficiary, issued by a bank acceptable to Liberty Mutual. The substitute letter of credit shall have a term of at least 12 months unless otherwise negotiated and agreed to in writing between Liberty Mutual and the Policyholder.

The amount of the substitute letter of credit shall be at least the difference between "estimated final premium" and the "premium payable", as indicated on the attached schedule. If at anytime before the fourth retrospective adjustment, the Policyholder's outstanding liability – i.e. the "estimated final premium" or "revised estimated final premium" (as defined in Item 6. of this agreement) less any "premium payable" amounts paid to Liberty Mutual – is greater than the amount of the letter of credit, Liberty Mutual shall have the option to require the Policyholder to deliver an amendment to the existing letter of credit or an additional letter of credit (in substantially similar form as the attached specimen) issued by a bank acceptable to Liberty Mutual and for a term of at least 12 months, unless otherwise negotiated and agreed to in writing between Liberty Mutual and the Policyholder, within 30 days of notice to cover the amount of such excess.

If the fourth retrospective adjustment or subsequent retrospective adjustment indicates that the outstanding liability – i.e. the "revised billed premium" amount (as defined by Item 3. of this agreement) less any "premium payable" amounts paid to Liberty Mutual – is greater than the amount of the letter of credit, the Policyholder

shall deliver an amendment to the existing letter of credit or an additional letter of credit (in substantially similar form as the attached specimen) issued by a bank acceptable to Liberty Mutual and for a term of at least 12 months, unless otherwise negotiated and agreed to in writing between Liberty Mutual and the Policyholder, within 30 days of notice to cover the amount of such excess.

The Policyholder's duty to deliver a substitute letter of credit to replace an expiring letter of credit shall continue until the Policyholder has paid or liquidated all amounts of "revised billed premium".

10. *Full Payment Option.* If the Policyholder fails to deliver an amended or additional letter of credit as required in compliance with Item 8. of this agreement, or if the Policyholder fails to deliver a substitute letter of credit or an amended or additional letter of credit as required in compliance with Item 9. of this agreement, then Liberty Mutual shall have the option to require the Policyholder to pay immediately upon notice the entire "billed premium" for 12 months or, if such event occurs after one or more audits or retrospective adjustments have been made, the entire "revised billed premium" less (in either case) all of the Policyholder's payments of "premium payable" received by Liberty Mutual.

11. *Drawing Upon the Letter of Credit.* Liberty Mutual agrees to draw upon any letter(s) of credit only to the extent of any "premium payable" amounts overdue as determined under this agreement except:

(a) If any of the insurance policies listed in this agreement are cancelled, or

(b) if the Policyholder fails to deliver an amended or additional letter of credit as required in compliance with Item 8. of this agreement, or

(c) If the Policyholder fails to deliver a substitute letter of credit or an amended or additional letter of credit as required in compliance with Item 9. of this agreement,

then Liberty Mutual may draw upon the full amount of the letter(s) of credit.

12. *Cancellation.* In case of cancellation by either party of any of the policies covered by this agreement, the premium shall be computed in accordance with the policy. Any amount of unpaid premium will become "billed premium" and will be due and payable immediately upon receipt of notice from Liberty Mutual to the Policyholder. It is understood that "cancellation" of a policy does not include policy nonrenewal.

Accepted for Policyholder	Accepted for Liberty Mutual
/s/ Carol F. [Illegible]	/s/ C. Pat [Illegible]
Risk Manager TITLE	ASSISTANT SECRETARY TITLE
P.A. Bergner & Co.	Liberty Mutual
September 4, 1990	SEP. 21, 1990
DATED	DATED

RELEVANT STATUTORY PROVISIONS

Section 547 of the Bankruptcy Code, 11 U.S.C. § 547, provides in pertinent part:

> (b) Except as provided in subsection (c) of this section, the trustee may avoid any transfer of an interest of the debtor in property –
>
> (1) to or for the benefit of a creditor;
>
> (2) for or on account of an antecedent debt owed by the debtor before such transfer was made;
>
> (3) made while the debtor was insolvent;
>
> (4) made –
>
> (A) on or within 90 days before the date of the filing of the petition; or
>
> (B) between 90 days and one year before the date of the filing of the petition, if such creditor at the time of such transfer was an insider; and
>
> (5) that enables such creditor to receive more than such creditor would receive if –
>
> (A) the case were a case under chapter 7 of this title;
>
> (B) the transfer had not been made; and
>
> (C) such creditor received payment of such debt to the extent provided by the provisions of this title.
>
> (c) The trustee may not avoid under this section a transfer –

(1) to the extent that such transfer was –

(A) intended by the debtor and the creditor to or for whose benefit such transfer was made to be a contemporaneous exchange for new value given to the debtor; and

(B) in fact a substantially contemporaneous exchange; [or]

(2) to the extent that such transfer was –

(A) in payment of a debt incurred by the debtor in the ordinary course of business or financial affairs of the debtor and the transferee;

(B) made in the ordinary course of business or financial affairs of the debtor and the transferee; and

(C) made according to ordinary business terms . . . .